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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1944

No. 264

GUARANTY TRUST COMPANY OF NEW YORK,
PETITIONER,

vs.

GRACE W. YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 17, 1944.

CERTIORARI GRANTED OCTOBER 9, 1944.

INDEX

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

GRACE W. YORK,

Plaintiff-Appellant,

—against—

GUARANTY TRUST COMPANY OF NEW YORK,
A CORPORATION,

Defendant-Appellee.

Statement Under Rule XIII.

This action was commenced by the serving and filing of a summons and complaint on the 22nd day of January, 1942. The defendant on July 9, 1943, moved for a summary judgment in its favor, supported by affidavits and exhibits. The plaintiff filed a counter motion for a summary judgment in her favor. The matter was argued orally and written briefs were submitted. On October 7, 1943, Judge Simon H. Rifkind rendered his opinion granting defendant's motion, and denying plaintiff's motion, and on October 22, 1943, judgment was entered in said defendant's favor and against the plaintiff, from which this appeal is prosecuted by the said plaintiff. Notice of Appeal was filed on November 5, 1943.

DISTRICT COURT OF THE UNITED STATES

For the Southern District of New York.

Civil Action No. 17-165.

Grace W. York,

Plaintiff,

vs.

Guaranty Trust Company of New York,
a corporation,

Defendant.

Plaintiff, Grace W. York, in her own right and for the use and benefit of the entire class of the noteholders aggregating $1,213,000 of a note issue of $30,000,000, complains of the defendant, Guaranty Trust Company of New York, a corporation, and says:

1. Plaintiff is a citizen and resident of the State of Pennsylvania, having her place of residence in the City of Allentown, Pennsylvania, and the defendant, Guaranty Trust Company of New York, is a corporation organized and existing under and by virtue of the laws of the State of New York, and is a citizen and resident of the State of New York. The matter in controversy exceeds, exclusive of interest and costs, the sum of $3,000, and the federal jurisdiction is founded on the diversity of citizenship.

2. Plaintiff is the owner of $6,000 in notes of a $30,000,000 note issue hereinafter described, of which there are now outstanding $1,213,000 in principal amount of notes, and on which there is due interest at 6% from November 1, 1932 to date.

3. These notes are part of a series of a note issue of $30,000,000 executed by Van Sweringen Corporation, (hereinafter called "Company"), wherein the defendant, Guaranty Trust Company of New York, was named as Trustee under a trust indenture which was executed by the Company on May 1, 1930, securing the series of notes in the aggregate amount of $30,000,000, bearing interest at 6% per annum payable semi-annually, the principal amount being due and payable on May 1, 1935.

4. The trust indenture securing the $30,000,000 note issued provided, among other things, that the Company would maintain in its treasury "segregated assets" to the extent of 50% of the principal amount of the outstanding notes until the note issue will be reduced to $15,000,000. The principal officers of the Company, O. P. and M. J. Van Sweringen, agreed, as part consideration for the sale of the notes to the public, to enter into an agreement with the Guaranty Trust Company for the exclusive use and benefit of the noteholders, to keep the "segregated assets" in liquid market condition so that their market would always remain 50% of the amount of the outstanding notes, and in the event of a decrease in their market value, to supply additional securities to make up such deficiency, which securities were to be designated as "assigned securities". These "assigned securities" were to be supplied within 20 days from the date when any deficiency occurred.

5. Simultaneously with the execution of the trust indenture and with the execution of the notes secured thereby, the said principal officers of the Company entered into the agreement with the Guaranty Trust Company of New York, the Trustee, which agreement was dated May 1, 1930. The agreement provided, among other things:

(a) Van Sweringens agreed to repair any deficiency in the "segregated assets" by supplying "assigned securities" making up such deficiency.

(b) The "assigned securities" were to be held in the corporate treasury and were available to its creditors, subject to certain conditions enumerated in the agreement.

(c) In the event of a default under the terms of the agreement, the Guaranty Trust Company, as Trustee, was authorized to institute appropriate proceedings for the enforcement of the terms.

(d) The agreement was made for the exclusive benefit of the holders of the $30,000,000 in notes, as it more fully appears from a copy of the agreement which is attached hereto as Exhibit "A" and made a part hereof.

6. The trust indenture referred to the terms of the agreement and provided that the exclusive right of action was vested in the Trustee. It further provided that it was discretionary with the Trustee to accelerate the note issue upon default in the payment of interest, and upon demand in writing of at least 25% of the outstanding notes, the Trustee was bound to accelerate the note issue and to take the appropriate action. Some excerpts of the trust agreement are hereto attached as Exhibit "B" and made a part hereof.

7. On or about October 29, 1931, there were outstanding notes in the hands of the public amounting to $26,246,000. The interest thereon was due November 1, 1931, and the Company had no funds to meet the interest payments. There was sufficient cash in the "assigned securities" to pay 50% of the outstanding notes. In the event

of the failure to pay the interest, the Trustee was authorized to enforce the terms of the agreement, to accelerate the note issue and to apply the "assigned securities" in payment of 50% of the note issue, and to obtain a deficiency for the balance, and to collect that balance from the remaining assets of the Company which consisted of an investment in the Cleveland Terminals Building Company, (hereinafter called "Terminals Company"), its wholly owned subsidiary, in excess of $29,000,000, and in a claim on an open account due to the Company from its subsidiary in the sum of $27,154,584.03.

8. The defendant, Guaranty Trust Company of New York, the Trustee of the note issue, was then a creditor of the Terminals Company as participant in a loan of $39,500,000 made October 30, 1930, wherein said Trustee, together with J. P. Morgan, loaned to the extent of $22,000,000, each one contributing $11,000,000, which loan was evidenced by a note of the Terminals Company in the amount of $23,500,000, secured by all of the securities of the Terminals Company, and another note of $16,000,000 executed by the Vaness Company, the parent of the Van Sweringen Corporation, and among the securities for that note was all of the common stock of the Van Sweringen Corporation.

9. The interest on both notes was due November 1, 1931, and neither the Vaness Company nor the Terminals Company, nor any of its officers were in a position to meet these payments.

10. The Guaranty Trust Company, the Trustee of the $30,000,000 note issue, was interested in the $30,000,000 note issue, not only as Trustee, but as the parent of the Guaranty Company, its wholly owned subsidiary, which

participated in the syndicate which sold the $30,000,000 note issue to the public.

11. Faced with a situation which threatened a default in the $30,000,000 note issue which was sold to the public by the subsidiary of the Trustee, a default in the $23,-500,000 note of the Terminals Company and in the $16,-000,000 note of the Vaness, the parent of the Van Sweringen Corporation, and to avoid bankruptcy proceedings against all of these corporations, the defendant, Guaranty Trust Company of New York, through its agency, J. P. Morgan & Company, and through its officers, devised a plan to prevent such proceedings and to eliminate all creditors who would press payment from such companies, and for such purpose they agreed to the following:

(a) To procure the exchange of the $30,000,000 notes for common stock which was held as security for the debt of Vaness.

(b) To use the "assigned securities" for the purpose of acquiring one-half of the notes which were to be cancelled, thereby freeing the balance of the "assigned securities", and in order to meet the interest payment that was due November 1, 1931, and to use the balance after the application of a part thereof in purchase of the outstanding notes as security for their outstanding loans.

(c) To prevent any other creditor from enforcing collection against the Terminals on the open account in excess of $27,000,000 due to the Van Sweringen Corporation from the Terminals Company, and to enable the Guaranty Trust Company and the other bankers to be the only substantial creditors against the Terminals Company.

(d) To deprive the noteholders who would not consent to the foregoing terms from participation in any of the "assigned securities" and from the enforcement of their claims against any of the other assets.

12. To accomplish the foregoing a secret agreement was entered into with the knowledge, consent and approval of the Guaranty Trust Company of New York, dated October 29, 1931, which provided in substance as follows:

(a) That a public offer would be made in the name of the Van Sweringen Corporation to purchase the outstanding notes by paying therefor 50% in cash out of the "assigned securities" and the balance of the 50% to be paid in common stock of the Van Sweringen Corporation.

(b) One-half of the notes were to be cancelled and thereby the remainder of the "assigned securities" would be turned over as collateral on the notes held by Morgan.

(c) The other half of the notes would remain as an obligation of the Van Sweringen Corporation and would be substituted as collateral security with Morgan in lieu of the common stock.

(d) The balance remaining in the "assigned securities" was to be turned over to Morgan to be applied on account of the outstanding notes.

(e) The form of the offer to be submitted was made a part of the agreement.

(f) A copy of the agreement and offer is hereto attached as Exhibit "C" and made a part hereof.

13. This offer was submitted to all noteholders in the form as set forth in Exhibit "D" hereto attached. The

facts that the Trustee was a creditor of the Terminals Company and of the Vaness, that the common stock was held by them as security, and that they would get the uncancelled notes in lieu of the stock as security were not revealed to the noteholders, nor were any of the other facts enumerated in paragraphs 9, 10, 11 and 12 disclosed, but such facts were concealed from the noteholders.

14. As a result of the foregoing offer $15,000,000 of the notes were cancelled, $13,787,000 of the notes were acquired by the Guaranty Trust Company and Morgan as substituted security in lieu of the common stock, which notes, together with other collateral, were later sold by them at a public sale on September 30, 1935, and the proceeds applied against the collateral notes. The common stock which was given to the noteholders was worthless and known to be worthless to the Guaranty Trust Company of New York at the date when the offer was made. As a further result of the foregoing offer and acceptance, the noteholders who accepted the offer were eliminated as creditors of the Van Sweringen Corporation excepting $1,213,000 in notes, which noteholders refused to accept the offer, but they were in no position to take any action due to the fact that the exclusive right of action was vested in the Trustee, and they had no right to demand any action as they lacked the requisite 25% of the outstanding notes. The Guaranty Trust Company of New York and J. P. Morgan & Company and the other bankers who participated in the foregoing $39,500,000 loan remained as the only creditors who could enforce payment against the Terminals Company, and were the only creditors who had the required amount to enforce payment against the Van Sweringen Corporation.

15. Plaintiff is the owner of notes Nos. M-14424, M-25385, M-10728, M-10729, M-10732, and M-10733 aggregating $6,000, which are part of the $1,213,000 in notes now outstanding and which are in default, the last interest having been paid thereon on November 1, 1932. The $13,787,000 in notes which were sold by Morgan to Midamerica were declared by a court of competent jurisdiction uncollectible for the reason that the purchase by Midamerica at the Morgan sale was fraudulent, so that the $1,213,000 are the only creditors who are entitled to participate in the "assigned securities".

16. As a result of the foregoing scheme, the Guaranty Trust Company of New York, as Trustee, together with J. P. Morgan & Co. and the other bankers, received out of the "assigned securities" $1,245,279.98, which they applied towards the payment of the foregoing collateral notes, and they diverted the payment of $553,860 to the Vaness Company in purchasing subordinated notes of the Van Sweringens, and applied the further sum of $65,779.21 in furnishing the funds to the Vaness Company to purchase another claim for Morgan so that as a result of the offer the Trustee was party to an arrangement whereby in excess of $1,213,000 was directly diverted from the "assigned securities" to its personal benefit.

17. It was the duty of the Guaranty Trust Company of New York, as Trustee, to protect the "assigned securities" which were given for the exclusive benefit of all noteholders under the terms of the agreement, and when the interest was not available it was its duty to exercise its discretionary power to accelerate the note issue and to apply all of the "assigned securities" in payment of 50% of the note issue and obtain a deficiency decree in

excess of $15,000,000 for the balance of the debt and to enforce that deficiency against the assets of the Van Sweringen Corporation, which consisted of over $29,000,000 in capital investment in the Terminals Company and of an open account against it in excess of $27,000,000. No bankruptcy could have been commenced against the Van Sweringen Corporation as there were no other existing creditors who could maintain any bankruptcy proceeding, and the Trustee could appropriate all of the "assigned securities" for the exclusive benefit of the noteholders who were the only existing creditors. The Trustee failed to perform its duty because of its adverse interest as creditor of the Terminals Company and as the parent of the subsidiary which participated in the sale of the $30,000,000 note issue in the manner and form as above stated.

18. Because of the adverse position of the Trustee it actively participated in the offer whereby the "assigned securities" and other available assets were taken away from the plaintiff, as well as the other outstanding notes in the total sum of $1,213,000, and were appropriated for its personal use and benefit in the manner and form as above stated.

19. Due to its adverse position it was the duty of the Trustee to reveal all of the information and all of the facts as set forth above, which it failed to do, and the only information that was given to the noteholders were the facts contained in the foregoing "offer" attached hereto as Exhibit "D", and by such means the outstanding $1,213,000 in notes were in no position to make a demand upon the Trustee to take any action nor were any of the facts made known to them until this day.

20. Plaintiff had no knowledge of the facts, and some of the facts pertaining to the participation of Morgan in the above transactions were made known to her in the middle of the year 1940, at which time she joined in a Complaint filed by one Elias Hackner against J. P. Morgan & Company and Guaranty Trust Company, as noteholders who accepted the offer and received the worthless stock in lieu of the notes. The Court, however, held that this plaintiff was improperly joined in that proceeding*, and she was dismissed out from that proceeding because of misjoinder. She learned the additional facts pertaining to the active participation of the Guaranty Trust Company in the "offer" whereby the "segregated assets" and "assigned securities" were taken away and that it participated in the entire plan for the purpose of avoiding bankruptcy proceedings in which all noteholders would have participated equally from the affidavits which were filed in the Hackner proceedings, on behalf of the Guaranty Trust Company, in December, 1941.

21. The Van Sweringen Corporation is wholly insolvent and no substantial recovery can be had against it, and the plaintiff and the other noteholders stand to lose the entire face value of the outstanding notes.

22. Plaintiff, therefore, brings this action in her own right and for the common use and benefit of the entire class of the $1,213,000 notes and interest due thereon from November 1, 1932. The interest of the plaintiff as beneciary under the trust indenture is identical and in common with the interest of all other beneficiaries under the trust agreement who are holders of the outstanding notes

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* See *Hackner v. J. P. Morgan, et al.*, 117 F. (2) 95.

in the aggregate amount of $1,213,000. All of such noteholders are jointly and commonly interested in the proceeds received by the defendant, the Trustee of the bond issue, and appropriated to its personal use and benefit out of "assigned securities". They are also jointly and commonly interested in the cause of action against the defendant, as Trustee of the note issue, for the breach of faith and infidelity. The noteholders are widely scattered and it would be too expensive to join them as parties, and the plaintiff, therefore, files this suit for their joint benefit as a class suit.

Wherefore, plaintiff prays the following relief:

(a) That the Court may find and determine that the Guaranty Trust Company of New York, the Trustee of the note issue, breached its trust duties and obligations to the entire class of the $1,213,000 outstanding notes, and that it is liable to them for the breach of its trust duties and obligations, in such amount or amounts as this Court may find due to them upon a proper accounting.

(b) That the Court may find and determine that because of the participation of the Trustee of the note issue in the fraudulent offer whereby the "assigned securities" were misappropriated to the personal use of this defendant, that it is liable on account of the outstanding notes for principal and interest in the full amount of $1,213,000 plus interest at 6% from November 1, 1932, or

(c) In the alternative, that the defendant be held liable to the extent of the benefits it received out of the application and diversion of the "segregated assets" and "assigned securities" in such amount or amounts as the Court may find due from it upon a proper accounting.

(d) That the Court may grant such other relief in the premises as to equity may seem meet.

Meyer Abrams and Bennett I. Schlessel,
Attorneys for Plaintiff.

Shulman, Shulman and Abrams,
134 North LaSalle Street,
Chicago, Illinois,

Bennett I. Schlessel,
1450 Broadway,
New York, N. Y.,
Attorneys for Plaintiff.

Exhibits Attached to Complaint.

Exhibit "A" attached to the complaint is a copy of an agreement which appears at pages 105-111 of the printed record hereinafter referred to.

Exhibit "B" consists of excerpts from the Trust Indenture which appears at pages 75-90 of the said printed record.

Exhibit "C" is a copy of the agreement which appears at pages 119-126 of the aforementioned record, having attached thereto (as Exhibit "A") the offer which appears at pages 70-73 of the said printed record as Defendant's Exhibit 4 for identification.

Defendant's Notice of Motion for Summary Judgment.

[SAME TITLE]

Sirs:

Please take notice that upon the summons and complaint herein, the annexed stipulation of facts dated July 9, 1943, the annexed affidavit of Frederick A. O. Schwarz sworn to July 9, 1943, and the following papers filed in the action in this Court entitled "Elias Hackner et al., Plaintiffs, against J. P. Morgan et al., Defendants" (Civil Action No. 8-344): (1) the complaint as amended after giving effect to an order dated June 11, 1941, eliminating certain allegations; (2) the affidavits of George Whitney sworn to December 17, 1941, and of Alfred Shriver and Arthur E. Burke, both sworn to December 18, 1941, together with the exhibits annexed thereto; (3) Exhibits 2 and 4 for identification annexed to the deposition of Eunice E. Eastman; (4) Exhibit E annexed to plaintiff's request for admissions; and all the proceedings heretofore had herein and in the aforesaid action, the undersigned will move under Rule 56 of the Rules of Civil Procedure on a day for the hearing of motions at the United States Court House, Foley Square, New York, N. Y., July 20, 1943, at 10:30 A.M., or as soon thereafter as counsel can be heard for summary judgment in favor of the defendant Guaranty Trust Company of New York against the plaintiff Grace W. York, together with the costs and disbursements of the

action; and for such other and further relief as may be just and proper.

Dated: New York, N. Y., July 9, 1943.

Yours, etc.
Davis Polk Wardwell Gardiner & Reed,
Attorneys for Defendant,
Office and Post Office Address:
No. 15 Broad Street,
New York, N. Y.

To:
Bennett I. Schlessel, Esq.,
and
Messrs. Shulman, Shulman & Abrams,
Attorneys for Plaintiff,
1450 Broadway,
New York, N. Y.

Stipulation of Facts Attached to Notice.

[SAME TITLE]

It is hereby stipulated by the respective parties hereto, as follows:

1. This action was commenced on January 22, 1942.

2. The notes of Van Sweringen Corporation numbered M-14424, M-25385, M-10728, M-10729, M-10732 and M-10733, referred to in paragraph 15 of the complaint herein, were originally acquired by the firm of Warren W. York & Company. On April 19, 1934, the plaintiff received said notes as a gift and she has been the owner and holder thereof since that date.

3. That the printed record filed in the United States Circuit Court of Appeals for the 2nd Circuit in the appeal from Civil Action File No. 8-344 be filed and considered as part of the record in this cause for the convenience of the parties and the court.

4. That this court may consider, in connection with any pleadings to be filed by the respective parties, the following matters which appear in said printed record:

(a) Complaint as amended, after giving effect to the Order dated June 11, 1941, eliminating certain allegations (pp. 3-10).

(b) Affidavits of George Whitney and Alfred Shriver, with exhibits attached to the respective affidavits (pp. 15-46, 75-126).

(c) Affidavit of Arthur E. Burke (pp. 47-49).

(d) Exhibits 2 to 4 for identification (pp. 61-73).

Stipulation of Facts Attached to Notice.

(e) Exhibit E (pp. 127-128).

5. That the facts set forth in the affidavits are true and that the exhibits are true and correct.

Bennett I. Schlessel,
Meyer Abrams,
Attorneys for Plaintiff.

Davis Polk Wardwell Gardiner & Reed,
Attorneys for Defendant.

Dated: July 9, 1943.

Affidavit of Frederick A. O. Schwarz Attached to Notice.

[SAME TITLE]

State of New York,
County of New York—ss.:

Frederick A. O. Schwarz, being duly sworn, deposes and says:

I am a member of the firm of Davis Polk Wardwell Sunderland & Kiendl, formerly Davis Polk Wardwell Gardiner & Reed.

On September 30, 1935 I attended the public auction of the collateral securing the loans made by the banking group to The Vaness Company and the Cleveland Terminals Building Company, which is referred to in the affidavits of George Whitney and Alfred Shriver, sworn to December 17, 1941 and December 18, 1941 respectively, in the action in this Court entitled "Elias Hackner, et al., Plaintiffs, against J. P. Morgan, et al., Defendants" (Civil Action No. 8-344).

I represented the banking group at the auction sale and personally participated in the bidding. The collateral securing The Vaness Company loan was divided into two groups. The following collateral comprised Parcels 1 through 28 in Group No. 1:

Parcel No.	
1-6	629,132 shares Alleghany Corporation Common Stock
7	6,915 shares Alleghany Corporation Preferred Stock

Affidavit of Frederick A. O. Schwarz Attached to Notice.

8-11	40,393	shares Cleveland Railway Company Capital Stock
12	250	shares Huron Fourth Company Capital Stock
13	196	shares Long Lake Company Capital Stock
14	17,000	shares Terminal Building Company Capital Stock
15	122,000	shares Van Sweringen Company Common Stock
16	1,244,580	shares Van Sweringen Corporation Common Stock
17	$139,000.00	principal amount Alleghany Corporation 5% Bonds of 1950.
18	$270,000.00	principal amount Cleveland Terminals Building Company 2nd Mortgage 6% Bonds due 5/1/35.
19	$817,460.36	principal amount Long Lake Company 6% Demand Notes
20	$278,204.84	principal amount Metropolitan Utilities, Inc. 6% Demand Notes.
21	$207,176.60	principal amount Terminal Building Company 6% Demand Notes
22	$170,430.29	principal amount Terminal Hotel Company 6% Demand Notes
23	$6,261,697.59	principal amount Van Sweringen Company 6% Demand Notes
24	$13,787,000.00	principal amount Van Sweringen Corporation 5 year 6% Notes due 5/1/35
25	$554,103.00	principal amount Van Sweringen Corporation 6% Demand Notes

Affidavit of Frederick A. O. Schwarz Attached to Notice.

26 $2,595,398.85 principal amount Van Sweringen Corporation 6% subordinated Note due 5/1/35

27 $1,292,534.72 principal amount Higbee Company subordinated 6% Note due 3/1/34

28 $69,673.71 principal amount Higbee Company Note due 3/1/34

The following protective bids were made by me:

Parcel

1 $50,000 for 100,000 shs. Alleghany Corporation Common Stock

2 $40,000 for 100,000 shs. Alleghany Corporation Common Stock

3 $30,000 for 100,000 shs. Alleghany Corporation Common Stock

4 $20,000 for 100,000 shs. Alleghany Corporation Common Stock

5 $10,000 for 100,000 shs. Alleghany Corporation Common Stock

6 $12,914 for 129,132 shs. Alleghany Corporation Common Stock

7 $28,933 for 6,915 shs. Alleghany Corporation Preferred Stock

8 59⅞ per share for 10,000 shs. Cleveland Railway Company Capital Stock

9 59⅞ per share for 10,000 shs. Cleveland Railway Company Capital Stock

10 59⅞ per share for 10,000 shs. Cleveland Railway Company Capital Stock

11 59⅞ per share for 10,393 shs. Cleveland Railway Company Capital Stock

Affidavit of Frederick A. O. Schwarz Attached to Notice.

17 $29,885 for $139,000 principal amount of Alleghany Corporation 5% Bonds of 1950

19 $25,000 for $817,460.36 principal amount of Long Lake Company 6% Demand Notes

27 $83,330 for $1,292,534.72 principal amount of Higbee Company 6% Note due March 1, 1934

28 $52,256 for $69,673.71 principal amount of Higbee Company Note due March 1, 1934

At the direction of the New York banking group I made no protective bid on the $13,787,000 principal amount of Van Sweringen Corporation 5-year 6% notes due May 1, 1935 (Parcel 24), referred to in the complaint herein, or on any of the other securities contained in Group 1 except those listed above. Mid-America Corporation made a bid of $1,250 on the 250 shares of Huron Fourth Company Capital Stock (Parcel 12). No bids were made by Mid-America Corporation or any other person on the said Van Sweringen Corporation notes or on any of the other securities in Group 1 except a bid made by D. H. Silberberg & Co. of $20,000 on the Alleghany Corporation 5% Bonds of 1950 (Parcel 17). The total of the highest bids on Parcels 1 through 28 in Group 1 was $2,802,101.86. Mid-America Corporation then bid $2,803,000 on said parcels as a group. There being no other bids on Group 1, the securities were sold to Mid-America Corporation as a group at that price.

Frederick A. O. Schwarz

Sworn to before me this 9th day of July, 1943.

William H. Bruder
Notary Public, New York County
No. 326. New York County Register's No. 4B289. Commission expires March 30, 1944.

(Seal)

Plaintiff's Motion for a Summary Judgment.

[SAME TITLE]

To: Davis Polk Wardwell Gardiner & Reed
Attorneys for Defendant
15 Broad Street
New York City, N. Y.

Please Take Notice that plaintiff moves for a summary judgment based on the same documents mentioned in Defendant's motion for a summary judgment, and on the Stipulation of Facts attached thereto, and that this motion will be presented to the Court simultaneously with Defendant's motion, as Plaintiff's Counter Motion for the following relief:

1. That a summary judgment be entered for the Plaintiff for the common use and benefit of the holders of $1,213,000.00 of the notes described in the complaint, in the amount of $606,500.00, or in the first alternative:

2. That a judgment be entered in favor of the Plaintiff for her pro-rata share of the $606,500.00 which was available from the segregated assets for the note holders who did not accept the terms of the offer, and that due notice be given to all other holders of said notes to file their claims within a short date, and that judgment be entered for their pro-rata share, or, in the second alternative:

3. That the Defendant be required to account to the Plaintiff individually and for the common use and benefit of all note holders for the segregated assets and assigned securities which were not distributed to the $1,213,000.00 holders of said notes.

Meyer Abrams, and
Bennett I. Schlessel,
Attorneys for Plaintiff.

Opinion of Court.

[SAME TITLE]

MEMORANDUM.

Rifkind, J.

Both parties move for summary judgment upon the same papers. These papers consist of, 1, the complaint; 2, the complaint in the action entitled Elias Hackner, et al., Plaintiffs, v. J. P. Morgan, et al., Defendants; 3, three affidavits submitted by defendants on defendants' motion for summary judgment in the Hackner action; 4, three exhibits submitted by the defendants on defendants' motion for summary judgment in the Hackner action; 5, an affidavit by F. A. O. Schwarz, and, 6, a stipulation of facts. Both parties declare that only an issue of law divides them.

The substance of the complaint is that plaintiff is the owner of $6000 principal amount of notes of Van Sweringen Corporation issued pursuant to a trust indenture in which defendant is named trustee; that subsequent to the execution and delivery of the indenture, defendant acquired an interest in conflict with that of the noteholders by participating in loans to the parent and the subsidiary of the Van Sweringen Corporation; that thereafter, when the obligor of the notes became financially embarrassed and the defendant was in a position to take one of several courses, defendant took the one which served its own interest and neglected the interest of the noteholders; and that, in consequence, plaintiff's notes have become worthless. The prayer for relief seeks a judgment directing defendant to account to plaintiff, and other noteholders similarly situated, for the face amount of the notes plus

unpaid interest, or, in the alternative, for the benefit defendant received by means of its breach of duty.

The vicissitudes which attended the $30,000,000 note issue, of which plaintiff's notes are a part, the nature of the trust indenture, and the action taken by defendant are all fully set forth in Eastman v. Morgan, S. D. N. Y., 1942, 43 Fed. Supp. 637, affirmed, sub nom. Hackner v. Morgan, C. C. A. 2, 1942, 130 Fed. (2d) 300, certiorari denied, 317 U. S. 691. It is superfluous to repeat here what has already been so clearly recited. For present purposes it suffices to point out merely the feature which distinguishes the facts of the instant case. Whereas the Hackner action was on behalf of noteholders who had accepted the offer of the Van Sweringen Corporation and had received, in exchange for their notes, 50 cents on the dollar in cash and some common stock of the obligor corporation, plaintiff here belongs to the small group which rejected that offer. Holders of notes in the principal amount of $1,213,000 belonged to this group. In every other respect the facts of the two cases are identical, and the motions are made on the very affidavits upon which the Hackner motions were made. Upon such facts the Court of Appeals has held that no showing of a breach of trust has been made. A majority of the court regarded that conclusion adequate to support a dismissal of the complaint on the merits. This Court feels bound to respect the authority of the decision.

If the conduct of defendant was not wrongful, it must follow that any loss suffered by plaintiff was not ascribable to misconduct of the defendant but to plaintiff's failure to avail herself of the exchange offer, which on the basis of the facts here presented must be deemed to

have been a prudent proposal both from the point of view of the noteholders, as well as the defendant. Plaintiff stresses the presence of a fiduciary relationship between the defendant and the noteholders. Clarke v. Chase National Bank, C. C. A. 2, July 29, 1943. But by whatever name we call the aggregate of defendant's obligations, these were as present in the Hackner case as in the instant case. They were found, in the Hackner case, insufficient to support an action, irrespective of the argument of lack of damage. I am obliged to find that they fail to support an action here.

Defendant's motion is granted and the complaint dismissed. Plaintiff's cross motion is denied.

Simon H. Rifkind
U. S. D. J.

Dated, October 7, 1943.

Endorsed:
U. S. District Court.

Filed: Oct. 7, 1943.
S. D. of N. Y.

Order for Judgment

[SAME TITLE]

The above-named defendant, Guaranty Trust Company of New York, having moved under Rule 56 of the Rules of Civil Procedure for summary judgment in its favor against the plaintiff, Grace W. York, herein, and said plaintiff having made a cross-motion for summary judgment in her favor against said defendant, and the said motions having duly come on to be heard,

It is, on motion of Davis Polk Wardwell Gardiner & Reed, attorneys for defendant Guaranty Trust Company of New York,

Ordered, that defendant's said motion for summary judgment be and the same is hereby granted in all respects,

Further ordered that the cross-motion of plaintiff, Grace W. York, for summary judgment be and the same is hereby denied in all respects,

Further ordered, that the defendant, Guaranty Trust Company of New York, have judgment against the plaintiff, Grace W. York, herein, dismissing the complaint on the merits,

Further ordered, that defendant, Guaranty Trust Company of New York, recover judgment against the plaintiff, Grace W. York, for the costs and disbursements of this action,

Further ordered, that the Clerk of this Court is directed to enter judgment accordingly.

Dated: New York, N. Y., October 18, 1943.

Simon H. Rifkind

U. S. D. J.

Judgment.

[SAME TITLE]

The above named defendant Guaranty Trust Company of New York having moved under Rule 56 of the Rules of Civil Procedure for summary judgment in its favor against the plaintiff Grace W. York, and said plaintiff having made a cross-motion for summary judgment in her favor against said defendant, and the said motions having duly come on to be heard, and the Court having granted defendant's said motion for summary judgment in all respects, and having denied the cross-motion of said plaintiff in all respects by an order dated October 18, 1943, and filed in the office of the Clerk of this Court on October 18, 1943, and costs and disbursements having been taxed by the defendant in the sum of $21.40.

Now, on motion of Davis Polk Wardwell Gardiner & Reed, attorneys for said defendant, it is

Adjudged, that the complaint of the plaintiff Grace W. York be and the same hereby is dismissed on the merits, against the defendant Guaranty Trust Company of New York, and that said defendant recover of said plaintiff Grace W. York the sum of $21.40, its costs and disbursements as taxed, and that said defendant have execution therefor.

Judgment rendered and signed, October 22nd, 1943.

George J. H. Follmer
Clerk

Notice of Appeal.

[SAME TITLE]

Plaintiff, Grace W. York, by Meyer Abrams and Bennett I. Schlessel, her attorneys, hereby appeals to the United States Circuit Court of Appeals for the Second Circuit from the judgment entered in this cause on October 22, 1943, sustaining defendant's motion for a summary judgment against the plaintiff and denying plaintiff's counter motion for a summary judgment in her favor, and entering judgment for costs against the plaintiff, to the end that the judgment be reversed with directions to overrule defendant's motion, to grant plaintiff's counter motion, and to enter a summary judgment in plaintiff's favor against the defendant; and for such other relief as to the court may seem proper.

Grace W. York, Plaintiff,
Meyer Abrams
Bennett I. Schlessel,
Her Attorneys.

Dated, November 3, 1943.

Statement of Points.

The following is a statement of points upon which appellant relies in connection with the appeal taken from the summary judgment in defendant's favor:

1. The District Court erred in granting defendant's motion for a summary judgment and in entering judgment in favor of the defendant and against the plaintiff and taxing plaintiff with the costs.

2. It was the duty of the District Court to hold that the Trustee violated its fiduciary duty and actively participated in a scheme to deprive the plaintiff and the other noteholders of their share in the segregated assets to the extent of $606,500, and it was its duty to deny the defendant's motion for a summary judgment, and to direct it to answer or to enter the summary judgment in favor of the plaintiff and against the defendant.

3. It was the duty of the court to find that the defendant breached its fiduciary duty to the noteholders and that it gained an undue advantage over them while it stood in an adverse position, and by reason thereof the defendant is liable and accountable to the plaintiff as well as to the other noteholders who did not receive anything out of the assigned securities.

4. It was the duty of the court to hold that the relationship between the noteholders and the Trustee was of a fiduciary character regardless of the question whether the indenture constituted a trust, and it erred in holding otherwise.

5. The court erred in applying the decision in the Eastman case to this case and in entering the judgment based on such decision when it appeared to the court that the issues were different, and it was the duty of the court to pass upon the issues independently of the decision of the Eastman case.

6. It was the duty of the court to deny defendant's motion for a summary judgment and to direct it to answer the complaint on its merits, or in the alternative to grant the summary judgment in favor of the plaintiff; and the court erred in entering judgment against the plaintiff, and its judgment should be reversed with proper directions.

Meyer Abrams
Bennett I. Schlessel,
Attorneys for Plaintiff Appellant

Shulman, Shulman & Abrams,
Of counsel.

Stipulation As to Record on Appeal.

[SAME TITLE]

It is hereby stipulated and agreed by and between the parties to the above entitled cause, by their respective attorneys, pursuant to Rule 75 (f), that in lieu of serving and filing Designations as to the contents of the record on appeal herein, the following shall be included in the record on appeal:

1. Complaint filed in this action, with the elimination of the exhibits, but with the following description of the exhibits:

Exhibit "A" attached to the complaint is a copy of an agreement which appears at pages 105-111 of the printed record hereinafter referred to.

Exhibit "B" consists of excerpts from the Trust Indenture which appears at pages 75-90 of the said printed record.

Exhibit "C" is a copy of the agreement which appears at pages 119-126 of the aforementioned record, having attached thereto (as Exhibit "A") the offer which appears at pages 70-73 of the said printed record as Defendant's Exhibit 4 for identification.

2. Defendant's notice of motion for summary judgment, together with a stipulation of facts and affidavit of Frederick A. O. Schwarz attached thereto, all dated July 9, 1943.

3. Plaintiff's counter motion for summary judgment exclusive of proof of service.

Stipulation As to Record on Appeal.

4. The following papers filed in the action in this court entitled "Elias Hackner, et al., Plaintiffs, v. J. P. Morgan, et al., Defendants, Civil Action No. 8-344", are to be considered as a part of this record on appeal, but need not be printed in the record, and reference thereto may be made to the printed record already on file in the United States Circuit Court of Appeals for the Second Circuit in Case No. 325:

(a) The complaint as amended after giving effect to the order dated June 11, 1941, eliminating certain allegations, appearing on pages 3-10 of the aforementioned printed record;

(b) The affidavit of George Whitne dated December 17, 1941, the affidavit of Alfred Shriver dated December 18, 1941, and the affidavit of Arthur E. Burke dated December 18, 1941, together with the exhibits annexed thereto, which appear at pages 15-49 and 75-126 of said printed record;

(c) Defendants' Exhibits 2 and 4 for Identification attached to the deposition of Eunice E. Eastman, appearing at pages 61-73 of said printed record;

(d) Exhibit E annexed to plaintiff's Request for Admissions, appearing at pages 127-128 of said printed record.

5. Opinion of Court, dated October 7, 1943.

6. Order for judgment, and judgment.

7. Notice of Appeal.

8. Stipulation as to contents of record on appeal.

9. Statement of Points.

Stipulation As to Record on Appeal.

10. Certificate of Clerk, and stipulation as to record on appeal.

It is hereby further stipulated and agreed that the United States Circuit Court of Appeals on the appeal taken by the plaintiff herein may consider the papers mentioned in item 4 hereof, which appear in the aforesaid record, now on file with that Court, and that the plaintiff-appellant be given leave to file 13 additional copies of said printed record in Case No. 325, to be designated as Volume 2 of the Record on Appeal herein, and that an order may be entered accordingly subject to the approval of the Court.

Dated: New York, N. Y., November 10, 1943.

Meyer Abrams,
Bennett I. Schlessel,
Attorneys for Plaintiff-Appellant

Davis Polk Wardwell Gardiner & Reed
Attorneys for Defendant-Appellee.

Stipulation As to Record.

[SAME TITLE.]

It Is Hereby stipulated and agreed that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed upon by the parties.

Dated, New York, December ....., 1943.

Meyer Abrams and Bennett I. Schlessel,
Attorneys for Plaintiff-Appellant.

Davis Polk Wardwell Gardiner & Reed
Attorneys for Defendant-Appellee.

Certificate of Clerk.

[SAME TITLE]

United States of America,
Southern District of New York—ss.:

I, George J. H. Follmer, Clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed upon by the parties.

In testimony whereof, I have caused the seal of said Court to be hereunto affixed, at the City of New York, in the Southern District, this 6th day of December, in the year of Our Lord One Thousand Nine Hundred and Forty-three and of the Independence of the said United States the one hundred and sixty-eighth.

George J. H. Follmer,
Clerk

(Seal)

[fol. 35] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 256

GRACE W. YORK, Plaintiff-Appellant,

against

GUARANTY TRUST COMPANY OF NEW YORK, a Corporation, Defendant-Appellee

PETITION FOR REHEARING AND TO AMEND THE OPINION

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Your petitioner the appellee above named respectfully petitions for a rehearing and for further oral argument and an opportunity to file further briefs in this case, essentially upon the ground that the Court's opinion filed March 2, 1944, determines questions some of which were not heretofore argued or presented in this case; that such determinations are not only erroneous as a matter of law but in some instances revolutionary; and that in certain respects the opinion makes erroneous statements as to the record and should be amended.

By reason of the limitations of Rule XXVII we confine this petition to a brief statement of the grounds upon which reargument is sought, and are unable to set forth fully appellee's position with respect to each of them.

[fol. 36] *The grounds upon which reargument is more particularly sought are:*

1. That in finding a relationship of express trust between appellee and the noteholders this Court has both departed from the authorities established here and failed to give effect to the substantive law of New York (p. 3).

2. That with respect to the statute of limitations the opinion has misconstrued the decision of the Supreme Court in *Russell* v. *Todd*, 309 U. S. 280, and injected doctrines of substantive law which are contrary to the law of New York (p. 7).

3. That the opinion fails to apply the substantive law of New York with reference to exculpatory clauses in trust indentures (p. 11).

4. That the United States Courts lack jurisdiction of plaintiff's claim because it involves less than $3,000 (p. 14).

5. That plaintiff acquired her notes more than two years after the transaction complained of and has no right or capacity to maintain this suit (p. 18).

6. That the holding in the opinion to the effect that noteholders in plaintiff's class may, without being concluded by the outcome of her suit, come into her case at a later date without prejudice from the statute of limitations or laches, involves a fundamental inconsistency and is without precedent and is unsound (p. 19).

The points in which petitioner submits that the opinion requires amendment are:

7. That the opinion errs in stating that non-accepting noteholders received interest only up to November 1, 1931, [fol. 37] whereas in fact they received interest up to November 1, 1932 or a further 6% (p. 22).

8. That the record does not support the statements in the opinion that the appellee as "trustee" had any fear with respect to a liquidation of Van Sweringen Corporation as regards the outstanding loan by appellee and other banks to other corporations (p. 23).

9. That petitioner did not in the oral argument in this Court abandon its previous argument with respect to the alleged trust relationship or effect a shift of position (p. 24).

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1. In finding a relationship of express trust between appellee and the noteholders this Court has both departed from the authorities established here and failed to give effect to the substantive law of New York.

(a) The opinion erroneously characterizes as "dictum" the decision of the majority (Chase and Clark, *JJ.*) in the *Hackner* case to the effect that there was no trust (p. 1077). Three separate grounds were listed by the majority. In the first instance they held that no fraudulent misrepre-

sentations had been made to the plaintiff Eastman. As a second reason for affirmance the majority said (130 F. [2d] at 302-3):

> "Accepting the District Court's interpretation of the complaint as alleging a breach of trust as well as the fraud, we further agree that there was not, nor could there have been, any showing of a trust here * * * Here there is nothing upon which a trust can be founded."

[fol. 38] The Court then went on to say (p. 303):

> "There is, however, another reason why no action could be proved. For even assuming a fiduciary relationship, the plaintiff has suffered no loss or injury by the exchange."

This was listed as an "additional reason the judgment was right" (p. 303).

Judge Frank, who sat in the *Hackner* case, refused to concur in the determination with respect to the non-existence of a trust, saying (p. 303):

> "The other issues are less clear and I see no need to consider them".

This is an acknowledgment that the other members of the Court did consider and determine them. They are therefore not dictum.

What has happened is that the Court consisting of L. Hand, A. N. Hand and Frank, *JJ.* has overruled the Court consisting of Chase, Clark and Frank, *JJ.* with regard to the identical question of law upon the identical instruments within a space of two years; and it is respectfully submitted that, for the sake of uniformity and consistency of decision in the administration of justice, that should not occur, at least without full opportunity for argument and adequate consideration. However, the latest determination of this Court was made upon the incorrect understanding, as stated in the opinion (p. 1078), that appellee had this time abandoned and shifted its position. This mistake is referred to at page 24 below.

Attention may also be called to the fact that in the instant case the Court fails to follow its own decision of November 22, 1943 in *Driscoll, et al. v. Public National*

[fol. 39] *Bank & Trust Co.*, 139 F. (2d) 348 (Swan, A. N. Hand and Chase, *JJ.*), (Advance Sheets of February 7, 1944) affirming on the opinion below 52 F. Supp. 869. This case was cited in appellee's brief on this appeal, but is not mentioned in the opinion of the Court. The opinion of the Court (p. 1078) does cite *Clarke v. Chase National Bank*, 137 F. (2d) 797 (L. Hand, A. N. Hand, and Chase, *JJ.*), as holding that under a trust indenture there could be a fiduciary relation with resultant fiduciary obligations despite the absence of a *res*. But the *Clarke* case did not hold that there could be an *express trust* in the absence of a *res*. This Court does not in the opinion proper characterize the relationship here involved as an express trust; but footnote 15 on page 1083 terms the defendant here an express trustee, and this footnote will no doubt be deemed to be binding upon the trial court. As the point may have vital consequences, it is respectfully submitted that it should be reopened to argument. The opinion of the Court at page 1078 treats the conclusion reached in this case as an *addition to the previous decisions* of the Court ("We now add that where, as here, * * *").

(b) A second and independent ground why reargument should be had on this point is that the latest opinion of the Court fails to give effect to the substantive law of New York regarding trusts, although bound to do so by the rule of *Erie R. Co. v. Tompkins*, 304 U. S. 64. The opinion cites no New York law for the proposition that there can be an express trust where the trustee does not hold title to any property constituting a *res* for the benefit of the *cestui*. The New York law is distinctly stated in *Brown v. Spohr*, 180 N. Y. 201, 209:

> [fol. 40] "There are four essential elements of a valid trust of personal property: (1) a designated beneficiary; (2) a designated trustee, who must not be the beneficiary; (3) a fund or other property sufficiently designated or identified to enable title thereto to pass to the trustee; and (4) the actual delivery of the fund or other property, or of a legal assignment thereof to the trustee, with the intention of passing legal title thereto to him as trustee".

Other authorities in New York law and the leading Federal authorities are cited at page 14 of our brief on this appeal

and in Judge Chase's opinion in the *Hackner* case, 130 F. (2d) at 303. An instructive decision not heretofore cited is

> *Miller* v. *National City Bank*, N. Y. Law Journal, June 9, 1942, page 2446, Shientag, *J.*, aff'd 265 A. D. 1040, appeal denied 291 N. Y. 225 (memo.).

The opinion of March 2, 1944 does not discuss or distinguish any of these authorities.

Although intangible personal property such as a chose in action may constitute a *res* and give rise to an express trust, if actually transferred to the trustee to be held for the benefit of the *cestui*, no chose in action was transferred to or held by the defendant under the so-called trust indenture here. This Court has found (p. 1078) that the powers conferred upon defendant to sue on behalf of the noteholders and to accelerate the maturity of the notes in the event of default constituted powers in trust giving rise to an express trust, even though they did not pertain to any interest in any property. No authorities in either the New [fol. 41] York or the Federal courts are cited for this unique proposition, and such powers clearly do not fall within the definition of "powers in trust" set forth in Sections 131-138 of the New York Real Property Law.

The powers to sue and accelerate possessed by the appellee are quite like similar powers frequently granted to an agent under a power of attorney. An agent, although a fiduciary under certain circumstances, would clearly not become a trustee of an express trust merely because he was given such authority by his principal. The finding of an express trust in this instance seems an undue yielding to "verbal formulae"; *cf. Coomber* v. *Coomber*, [1911] 1 Ch. 723, 728-9.

2. With respect to the statute of limitations the opinion has misconstrued the decision of the Supreme Court in *Russell* v. *Todd*, 309 U. S. 280, and injected doctrines of substantive law which are contrary to the law of New York.

In *Russell* v. *Todd* the Supreme Court restated the well-established doctrine (p. 289):

> "Even though there is no state statute applicable to similar equitable demands, when the jurisdiction of the federal court is concurrent with that of law, or the suit

is brought in aid of a legal right, equity will withhold its remedy if the legal right is barred by the local statute of limitations."

No authorities are cited for the proposition advanced by this Court that York's suit is exclusively in equity (opinion p. 1089). In essence this suit is brought by York in aid of a legal right, *i.e.* the right to damages for defendant's in-[fol. 42] action or negligence in failing to liquidate Van Sweringen Corporation. Equity jurisdiction is not exclusive here as it was in the *Todd* case. The jurisdiction of equity is concurrent with that of law. As the opinion states (p. 1084), the measure of defendant's liability "is the loss suffered by the non-accepting noteholders, not the benefits derived by the trustee". It is clear, therefore, that the equitable remedy of accounting is not necessary, as it was in the *Todd* case. This Court's opinion (pp. 1078-9, 1083) makes clear that the sole basis for liability would be the inaction or failure of defendant to bring about the liquidation of the obligor on plaintiff's notes. Inaction or failure to act would constitute negligence and would result in an injury to property. Plaintiff in reality asks that defendant be made to pay her, under the guise of damages, the money which she would have realized if there had been no exchange offer and if defendant had compelled the liquidation of Van Sweringen Corporation in 1931.

Actions may be brought at law against indenture trustees for damages resulting from misconduct on their part in the performance of their trust duties. *Margulies* v. *Manufacturers Trust Co.*, 148 Misc. 564; *Hunsberger* v. *Guaranty Trust Company*, 164 A. D. 740; *James* v. *Cowing*, 82 N. Y. 449. Where the remedy at law is adequate, the legal period of limitations must be applied. *Keys* v. *Leopold*, 241 N. Y. 189; *Hanover Fire Insurance Co.* v. *Morse Drydock & Repair Co.*, 270 N. Y. 86; *Clarke* v. *Boorman's Executors*, 85 U. S. 493, 505. In *Russell* v. *Todd*, 309 U. S. at 289, are cited twelve other cases in the Supreme Court and the lower Federal Courts to the same effect. If a plaintiff is seeking damages for negligence or for injury to property resulting because of a breach of [fol. 43] fiduciary duty, the remedy at law is considered adequate. *Savings Bank of New London* v. *New York Trust Co.*, 27 N. Y. S. (2d) 963 (suit against indenture trustee); *Ansbacher* v. *New York Trust Co.*, 280 N. Y. 79 (suit

against indenture trustee); *Potter* v. *Walker*, 276 N. Y. 15; *Singer* v. *Carlisle*, 26 N. Y. S. (2d) 172, aff'd 261 A. D. 897, appeal denied 285 N. Y. 863; *Corash* v. *The Texas Company*, 264 A. D. 292; *Kalmanash* v. *Smith*, 291 N. Y. 142, 159. This is true even if the action be of a type cognizable in equity such as derivative stockholders' suits, where an accounting is always demanded of the defendant for breach of fiduciary duty. *Potter* v. *Walker*, *Singer* v. *Carlisle*, *Corash* v. *The Texas Company*, *supra*.

The gist of plaintiff's action is injury to property. It hence would be barred by the New York six-year statute (C. P. A. § 48, subd. 3), as it existed prior to September 1, 1936, when the period of limitations was reduced from six to three years.

Even if this suit were to be considered as being exclusively within the equity jurisdiction of the court, the rule stated in *Russell* v. *Todd* would require this Court to apply the New York ten-year statute of limitations embodied in § 53 of the Civil Practice Act. The Supreme Court there said (p. 289):

> "But where the equity jurisdiction is exclusive and is not exercised in aid or support of a legal right, state statutes of limitations barring actions at law are inapplicable, *and in the absence of any state statute barring the equitable remedy in like cases*, the federal court is remitted to and applies the doctrine of laches as controlling." (Italics supplied.)

[fol. 44] Since the Supreme Court found that there was no three-year statute in New York applicable to the cause of action there asserted but merely the ten-year statute applying to all actions in equity (C. P. A. § 53), the refusal of the lower courts to give effect to the three-year statute was upheld. But in the instant case there is a New York statute applicable to plaintiff's claim, even if considered as a claim cognizable only in equity. § 53 governs all equitable actions, including suits for breach of fiduciary duty where the remedy at law is inadequate. *Potter* v. *Walker*, 276 N. Y. 15; *Goldstein* v. *Tri-Continental Corporation*, 282 N. Y. 21. It has also been applied in an action against an indenture trustee for breach of duty. *Rhinelander* v. *Farmers' Loan & Trust Co.*, 172 N. Y. 519, 536. Under the rule of the *Todd* case, therefore, this Court should have

at least applied the ten-year statute, even though it did find, as we think erroneously, that the suit was exclusively in equity.

The rule of *Erie R. Co.* v. *Tompkins* requires exclusion from this case of the old equity doctrine of laches, because that rule requires this Court to follow the substantive law of New York and the doctrine of laches, which is a doctrine of substantive law (*Menendez* v. *Holt*, 128 U. S. 514), does not exist in the substantive law of New York. New York has abolished laches as a defense against a claim of right. The only defense against such a claim by reason of the lapse of time is limitations. *Pollitz* v. *Wabash R. Co.*, 207 N. Y. 113, 130. The use of the doctrine of laches to supplant limitations and thus to extend the period within which an action would otherwise be barred by statute, as was done here, has been foreign to the law of New York since 1848. Since that time New York has imposed a fixed limitation [fol. 45] of time upon every remedy, whether legal or equitable. *Gilmore* v. *Ham*, 142 N. Y. 1. Laches, having no longer a place in the law of New York as a bar to claims of right, should not be employed in the Federal equity practice in New York in derogation of the New York statute of limitations which precisely applies.

Although the application of the statute of limitations was argued in appellee's brief on this appeal, it was argued without reference to the question of *Russell* v. *Todd*, in reliance (justifiable, we submit) upon the principle already settled by the *Hackner* decision upon the same record that a trust is not here involved. The opinion of March 2, 1944 raises questions not heretofore presented, and determines points not argued by counsel on either side. As the point is an important one of general application, it is respectfully urged that further oral argument with opportunity for briefs on the subject would be in the interest of justice.

3. The opinion fails to apply the substantive law of New York with reference to exculpatory clauses in trust indentures.

The indenture here involved provided that the trustee "shall not be answerable * * * for anything whatever in connection with this trust except for its own wilful misconduct" (R. 98). The opinion, without citation of authority, assumes that defendant despite this exculpatory clause would be liable for any loss to any noteholder result-

ing from its failure to cause a liquidation of Van Sweringen Corporation, merely because of the "presence of a substantial adverse interest" (p. 1079), and even assumes further that defendant could probably have compelled such a liquidation in November, 1931 (pp. 1078-9), although the record [fol. 46] does not justify any such assumption. The opinion completely overlooks the provisions in the indenture permitting the trustee to occupy a dual position. The trustee was permitted to acquire, own and deal in the notes issued under the indenture and to "assert its rights in respect thereof in the same manner as any other noteholder" (R. 100). The indenture likewise allowed the trustee to "engage in or be interested in any financial or other transaction with the Company [Van Sweringen Corporation] or any corporation in which the Company may be interested", which would include the loan made to Cleveland Terminals Building Company (R. 100).

The opinion again disregards the exculpatory clause of the indenture in holding (p. 1083) that, even if defendant had no belief that its inaction would be to its own substantial benefit, it would still be guilty of a breach of trust provided an ordinary reasonable man, informed of the facts, would have thought that substantial selfish advantages might well accrue to the trustee through its failure to exercise the powers given to it under the indenture, and that under such circumstances it would make no difference whether the trustee in fact derived benefits if its inactivity caused loss to the beneficiaries. Such a test of liability eliminates any subjective element and thereby completely nullifies the provision in the indenture absolving the trustee from all liability except for "wilful misconduct". Under this standard, liability would be imposed even in the absence of negligence or fault of any kind. But it is the judgment and skill of this appellee for which the noteholders contracted, not the judgment and skill of the "ordinary practical reasonable man". In fact, the effect of the opinion of March 2, 1941 would seem to be that where two possible courses of action are open to a trustee, the first of [fol. 47] which is clearly better for the beneficiaries than the second, *he must at his peril adopt the course of action which will be worse for the beneficiaries* if the better course of action might involve the possibility of personal advantage to the trustee. This would seem clearly to be not only new law but bad law. Doubtful as would be the validity

of such a rule in any case, here it also cuts across the express contractual provision that the trustee is to be liable only for "*wilful* misconduct".

The Court thus failed to apply the New York law governing exculpatory clauses. Authorities sustaining and applying exculpatory provisions of this nature include *Ansbacher v. New York Trust Company*, 280 N. Y. 79; *Hazzard v. Chase National Bank*, 159 Misc. 57, aff'd 257 A. D. 950, aff'd 282 N. Y. 652; *Benton v. Safe Deposit Bank*, 255 N. Y. 260; and *Green v. Title Guarantee & Trust Co.*, 223 A. D. 12, aff'd 248 N. Y. 627.

The *Hazzard* case is dismissed in a footnote (p. 1083) as being different on the facts. The facts were different only in that they presented an infinitely stronger case for the imposition of liability on the trustee. Defendant there held securities concededly in trust for the benefit of debenture holders. The trial court found (159 Misc. at 63) that the trustee "occupied a position inconsistent with its role as trustee under the indenture" because it was the largest single creditor of the obligor of the debentures. He also found (p. 78) that the trustee had been negligent in permitting a substitution of worthless securities for the good securities held by it as security for the debenture holders. Yet the trial court and both New York appellate courts gave effect to the exculpatory clause in the indenture relieving the trustee of liability in the absence of gross negligence [fol. 48] or bad faith. In doing so Rosenman, *J.* (159 Misc. at 83-4) pointed out that a corporate trustee under an indenture has little in common with the ordinary trustee in so far as the duty of undivided loyalty is concerned; that the status of an indenture trustee is really more that of a stakeholder than a trustee; and that it is the common practice of corporate trustees to assume rather than refrain from occupying inconsistent positions.

This point was not argued previously because of appellee's reliance (again justifiable, we submit) upon the square holding in the *Hackner* case that no trust existed and because of the limitations of time and the rule of this Court limiting the brief. It is submitted that the principle of the opinion of March 2, 1944, revolutionary as it is and unsupported by the authorities, should not stand without at least further examination in the light of a reargument.

4. The United States courts do not have jurisdiction of plaintiff's claim because there is not involved $3,000 exclusive of interest and costs.

The opinion states (p. 1091a) that plaintiff's claim "with interest since 1931" appears to exceed the jurisdictional amount. In so far as a finding of jurisdiction is predicated upon interest, it is obviously in violation of 28 U. S. Code §41. The reference to the year 1931 is, as shown hereinafter, a misapprehension of this record. And this Court has already determined, and apparently still considers, that as much as $3,000 cannot be involved in the York claim.

York previously intervened as plaintiff in the *Hackner* suit. The *Hackner* suit as so constituted was dismissed by the District Court (Clancy, *D. J.*) on August 1, 1940, for [fol. 49] lack of the $3,000 jurisdictional amount. The proceedings appear in the transcript of the record in this Court in *Hackner* v. *Guaranty Trust Company*, 117 F. (2d) 95, certiorari denied 313 U. S. 559.

This Court (A. N. Hand, Swan, and Clark, *J. J.*) unanimously sustained dismissal for lack of jurisdiction saying (p. 98):

> "The proffered amendment added one plaintiff, York, who had never transferred her bonds; seemingly, therefore, she sustained no damage, but at any event, the possible loss of 50 per cent of her invesment of $6,000 would be just under the required amount".

York sought reargument with particular reference to the jurisditional point, but reargument was denied by this Court. Hence the opinion herein is in error in inferring (p. 1076) that York was dismissed in the prior case because "her claim was of a different character".

Upon a full presentation of the facts under Rule 56, this Court's opinion of March 2, 1944 concludes (p. 1071) that a liquidation of Van Sweringen Corporation would have yielded the noteholders a little more than 51% of the face amount of their notes from the segregated assets and assigned securities, if no allowance were made for liquidation expenses, and anywhere from 42.2% to 49% if such expenses, estimated at $590,000, were deducted.

Besides the segregated assets and assigned securities the only assets of Van Sweringen Corporation were about

$2,000 in cash, its stock investment in its subsidiary Cleveland Terminals Building Company, and the $27,000,000 open account indebtedness of the latter (R. 64). Upon substantially the present record, in the *Hackner* case the Court [fol. 50] (Chase, Clark, and Frank, *JJ.*) found that Van Sweringen Corporation's invesment in the stock of its subsidiary was "worthless" (130 F. [2d] 300 at 303). This Court (L. Hand, A. N. Hand, and Frank, *JJ.*) in the instant case says it appeared "to have become valueless" (opinion p. 1068). In the *Hackner* case this Court also found, upon substantially the present record, that the $27,000,000 open account indebtedness from Cleveland Terminals Building Company to Van Sweringen Corporation "was practically, if not entirely, worthless" (130 F. [2d] at 303).

By reason of these findings the Court (Chase, Clark, and Frank, *JJ.*) in the *Hackner* case found that the plaintiff Eastman, who accepted the offer and received 53 cents on the dollar, suffered no loss or injury. This finding in the *Hackner* case is accepted by the opinion herein (p. 1077), written by a Judge who participated in the *Hackner* case. Logically the finding constitutes a determination that non-accepting noteholders also could not have recovered more than 53 cents on the dollar if Guaranty Trust Company had forced a liquidation of Van Sweringen Corporation. It fixes a ceiling above which York's claim for damages could not hope to rise. But this ceiling is even lower than the Court thought, because of a further 6% payment which York admittedly received and which has been overlooked by the Court. As a non-accepting noteholder, York received a further 6% interest after the exchange offer, *viz.* interest up to and including November 1, 1932 (R. 34-5). This fact is undisputed and is confirmed by the fact that York in her present complaint asks interest only from November 1, 1932 (Tr. 11), not from November 1, 1931 as the opinion herein erroneously infers (p. 1076, 1091n).

[fol. 51] Deducting from York's potential 53 per cent. recovery the 6% interest received by non-accepting noteholders (November 1, 1931 to November 1, 1932), which accepting noteholders did not receive, and the 3% interest due November 1, 1931, which all noteholders received, we have it as a mathematical certainty that York could not have lost more than 44 cents on the dollar, or 44% of $6,000, or $2,640, by reason of the exchange offer. This

calculation jibes with the computations in the opinion herein, above mentioned, that the noteholders on liquidation would have received from 42.2% to 49% after deduction for expenses; or alternatively that the noteholders would have obtained little more than 51%, without allowance for expenses of liquidation. This figure is reduced to 42% by subtraction of the 9% additional interest received by non-accepting noteholders.

While it may be noted that the percentage computations of loss appearing in the opinion of March 2, 1944, do not take account of the open account indebtedness of Cleveland to Van Sweringen Corporation, which is given various values in the opinion, we do not assume that the author of the opinion meant to reverse the previous finding of this Court in the *Hackner* case, in which he concurred, that the open account indebtedness was practically worthless. Indeed the valuations of the open account indebtedness in this opinion appear not to be intended as findings at all but merely characterizations of a balance sheet (pp. 1086-7).

Since it now appears as a legal certainty that plaintiff's claim against defendant cannot possibly exceed $3,000 exclusive of interest and costs, this Court should dismiss the case for lack of jurisdiction rather than subject the defendant to a long and burdensome trial in a District Court lacking jurisdiction.

[fol. 52] 5. Having acquired her notes more than two years after the transaction complained of, plaintiff has no right or capacity to maintain this suit.

Plaintiff acquired her notes by gift more than two years after the alleged breach of trust complained of (Tr. 16). This undisputed fact was referred to several times in defendant-appellee's brief (pp. 2, 8, 38, 42), but was not separately argued and perhaps therefore not considered by the Court. Under the decision just rendered each non-accepting noteholder has an individual right of action to recover damages sustained by reason of the alleged breach of trust. But only noteholders who held their notes at the time of the alleged breach (*i.e.* in 1931), would have the right to maintain the action. *Elkind* v. *Chase National Bank*, 259 A. D. 661, aff'd 284 N. Y. 726; *Emmerich* v. *Central Hanover Bank & Trust Co.*, 291 N. Y. 570; *Clarke* v. *Chase National Bank* (Docket No. Civ. 17-121, S. D.

N. Y., not reported), aff'd 137 F. (2d) 797 (L. Hand, A. N. Hand and Chase, *JJ.*). The District Court had stated: "No action can be maintained by debenture-holders who were not such at the time the breaches of duty took place."

The *Elkind* case represents the substantive law of New York which should govern this situation. It is cited with approval by this Court in the *Clarke* case, 137 F. (2d) at 801. This Court in *Manufacturers Trust Co. v. Kelby*, 125 F. (2d) 650, made clear (p. 652) that it will follow New York Substantive law, including the *Elkind* case, but concluded that case was not applicable to a claim against an express trustee for restoration of trust property which had been misappropriated or wrongfully surrendered by the [fol. 53] trustee. This distinction is not applicable to the instant case. The appellee received from the debtor no property in trust for the noteholders, and there was no misappropriation or surrender of trust property.

It is difficult to see what equity or public interest is involved in presenting a complex and costly litigation of this character to a mere donee of paper where the donor, so far as appears, had himself no complaint regarding the transaction which occurred while he held it. While we did not present this question below, this Court may take notice of it where necessary in order to affirm the District Court. *American Legion Post v. First National Bank*, 113 F. (2d) 868, 872.

6. The holding to the effect that noteholders in plaintiff's class may, without being concluded by the outcome of her suit, come into her case at a later date without prejudice from the statute of limitations or laches, involves a fundamental inconsistency and is without precedent and is unsound.

The effect of this holding (opinion pp. 1091-4) is that other members of the so-called class may await the outcome of York's suit, take the benefit if she wins, but not be bound if she loses. In the meantime, according to the opinion, they are to suffer no prejudice from limitations or laches if they later determine to intervene, but apparently are to be barred by the lapse of time if they do not intervene but institute their own action. It is submitted that this decision will have unforeseen and undesirable consequences in

the application of Rule 23 and that, being without precedent, it should be examined on reargument. No previous oppor- [fol. 54] tunity has been given to counsel to discuss the question involved.

Neither the *Hackner* case nor this case is a true class suit, as this Court properly held, since the claims of the individual accepting and non-accepting noteholders are several. They fall within Rule 23(a)(3) which has been designated as a "permissive joinder device" (2 *Moore Federal Practice*, 2241). Actions brought thereunder are known as "spurious" class suits. *Hackner* v. *Guaranty Trust Company*, 117 F. (2d) 95, 97-8; *Central Mexico Light & Power Co.* v. *Munch*, 116 F. (2d) 85, 88. A judgment in such a suit is not binding on the other members of the class. It is therefore difficult to see why it should benefit any member of the class prior to the moment he actually joins.

Attention is called to the fact that the opinion of March 2, 1944 proceeds on a mistaken assumption in treating York's original participation in the *Hackner* suit as an intervention for her class. The *Hackner* suit was originally brought as a representative suit on behalf of noteholders who had accepted the exchange offer (record in this Court in first *Hackner* appeal p. 8). York's intervention by amendment did not characterize her as a member of the class but on the contrary excluded her from the class of accepting noteholders, and treated her as an individual (record in this Court in first *Hackner* appeal pp. 35-6). She did not purport to bring her suit at that time on behalf of the class of non-accepting noteholders. Hence footnote 22a on page 1092 of the opinion is erroneous.

Even if the *Hackner* suit had been brought on behalf of all noteholders, it is submitted that the rule stated by the Court should not be applied in a "spurious" class suit brought under Rule 23(a)(3). In *Deckert* v. *Independent* [fol. 55] *Shares Corporation*, 39 F. Supp. 592, cited in this Court's opinion, a District Court for Pennsylvania found the suit was of the "hybrid" variety under Rule 23(a)(2) rather than a "spurious" class suit. The reasoning of the Court as to the tolling of limitations in the type of suit there presented seems to be based upon the presence of a common fund in which the parties are equally interested. In a "spurious" class suit like the present no common fund is involved, the claims of the noteholders are separate, and

the defenses thereto may vary according to the noteholder involved, as this Court has pointed out.

The noteholders here could not have been lulled into a false sense of security, if they had known of the institution of the *Hackner* suit and York's attempted intervention therein because as shown by the complaint the action did not purport to be brought on their behalf. Presumably if any noteholders had heard of the case, they would have brought separate actions in their own right. The suggestion in the opinion (pp. 1093-4) that the commencement of a suit under Rule 23(a)(3) might act as a "trap" unless limitations or laches were to be tolled therewith for the benefit of subsequent intervenors, seems to lack reality. The commencement of such a suit will not act as a trap if either it is not known to the class or the legal effect is clearly announced by the Court.

There is no more reason why, so far as an inert member of the class is concerned, the commencement of a "spurious" class suit should extend his time to assert his own claim than there is that he should be bound by the judgment as *res judicata*. Yet he is not so bound if he does not intervene. The rule enunciated in this Court's opinion, would unfairly work to the defendant's disadvantage in the [fol. 56] "spurious" class suit, in that it would encourage possible claimants to stand by pending determination of the *York* action and thus postpone to the Greek Kalends the determination of the defendant's total liability and (what is worse from the point of view of either limitations or laches) also postpone the production of the documents and witnesses upon which the subsequent claims may depend. Yet, while the defendant is thus penalized, the members of the "class" may, if the *York* suit be successful, take its benefits without its burdens.

It would appear to us that the policy of such a rule, novel as it is, deserves re-examination.

7. The opinion is in error in stating that non-accepting noteholders received interest only up to November 1, 1931, whereas in fact they received interest up to November 1, 1932, or a further 6%.

The statement of the Court at page 1076 is:

"The non-accepting noteholders received for their investment nothing except interest up to, and including,

November 1, 1931 (*i.e.* interest for one and one-half years) * * *"

At page 16 above we have given the record references establishing that without dispute this statement is erroneous and the date November 1, 1932, meaning interest for two and one-half years, should be substituted.

[fol. 57] 8. The record does not support the statement in the opinion that the appellee as "trustee" had any fear with respect to a liquidation of Van Sweringen Corporation as regards the outstanding loan by appellee and other banks to other corporations.

The statement of the Court on this point appears at the middle of page 1070 and comprises the whole paragraph beginning "The trustee, however, feared * * *." Statements of a similar nature appear at pages 1080 and 1081. We believe these statements (particularly the first and third sentences of the paragraph beginning in the middle of p. 1070) are based upon a complete misconception of the record and constitute inadvertent error which may be seriously prejudicial to the defendant upon a subsequent trial. For the facts, which appellant has stipulated to be true (Tr. 16-7), reference is made to the very full affidavits of Messrs. Shriver, Whitney and Burke, more particularly at R. 43-5, 28, and 49. These fully establish honesty and good faith on the part of those acting for the appellee in connection with the exchange offer, and show its sole motive to have been the obtaining for *all* noteholders the best possible advantage under very difficult circumstances. In addition to honest motive the "trustee" brought to the situation expert judgment informed by legal advice, as these affidavits show. Under Rule 56 this record should have the legal weight attached to the evidence upon a full trial. Especially in connection with the question of the exculpatory clause above discussed, the gratuitous imputation to the "trustee" of conflicting considerations of fear and self interest is harmful and unfair, and should be corrected.

[fol. 58] 9. Petitioner did not in the oral argument in this Court abandon its previous argument with respect to the alleged trust relationship or effect a shift of position.

The Court's statement on this point is found in the middle of page 1078 and in footnote 13a. We regret that

the Court should have so fundamentally misunderstood the nature and object of our oral argument. In view of the limitation of time, the previous holdings of this Court as to the legal position, and the desire expressed by the Judges for a full discussion of the facts, appellee's counsel on the argument, held February 1, 1944, expressly confined themselves to the proposition that defendant met the highest standard of fiduciary conduct and that no damage was suffered by York in any event. In so doing, according to our own definite recollection, appellee's counsel fully reserved the question of the existence of a trust or fiduciary duty, leaving this question to the definite argument contained in the brief, and predicated the oral argument on the *assumption* that some kind of fiduciary duty existed.

Conclusion

By the opinion of March 2, 1944 this Court has reversed itself upon the law and to some extent upon the facts, and has announced propositions of law of possibly far-reaching effect without the attention or the argument or the briefs of counsel having been directed to these propositions. This is not the ordinary petition for rehearing. Many of the points covered in this petition will, if it be granted, be presented by counsel in this case for the first time. It is submitted that the proper administration of justice requires that this petition be granted, and that a date be set for the [fol. 59] filing of the briefs of counsel and for further oral argument upon the points above stated (except in so far as the Court may amend the opinion of its own accord on points of fact). We shall be glad to reargue the case generally, but we have confined our statement to the points of greatest import upon which we respectfully suggest that error has been committed.

Respectfully submitted, Davis Polk Wardwell Gardiner & Reed, Attorneys for Defendant-Appellee, Guaranty Trust Company of New York.

March 16, 1944.

[fol. 60] Certificate of Counsel

Ralph M. Carson, one of the attorneys for the petitioner and a member of the firm of Davis Polk Wardwell Gardiner & Reed (now Davis Polk Wardwell Sunderland & Kiendl),

attorneys for the petitioner, certifies that he is a member of the bar of this Court; that he has prepared the foregoing petition and is familiar with all the facts stated therein; that the foregoing petition is submitted in good faith and not for purposes of delay; and that he believes it to be meritorious.

New York, N. Y., March 16, 1944.

Ralph M. Carson.

[fol. 61] Grace W. York v. Guaranty Trust Company of New York

No. 256—October Term 1943

* * * * * * *

Having considered appellee's petition for rehearing, the court does not desire to hear further arguments concerning points 1, 6, 8 and 9 of the petition. Appellee, however, is given leave to file a brief, on or before April 10, 1944, with respect to the following:

1. In the light of the statement in *Russell* v. *Todd*, 309 U. S. 280, 287, ("The Rules of Decision Act does not apply to suits in equity"), this court thinks that, as to state statutes of limitations in suits of equity, the doctrine remains what it was before *Erie* v. *Tompkins*, 304 U. S. 64. On that basis, is not the character of the equity jurisdiction here to be decided without reference to state decisions allowing such a suit to be brought at law? If so, what is the nature of the present suit under federal decisions? Even if, under federal decisions, this suit is not exclusively within the jurisdiction of equity, will not the federal decisions as to laches apply here, because the state statutes of limitations "conflict with equitable principles" due to the "inequitable conduct of the defendant?" (See 309 U. S. 288, footnote 1.)

2. If this suit were pending in a New York State Court, would the New York decisions cited in point 3 of appellee's petition relieve appellee of liability, or do the facts here serve to distinguish this case?

3. Even if those decisions would exculpate defendant in such a suit, must this court follow them, in the light of

the statement in *Russell* v. *Todd*, quoted above? Cannot a federal court in New York, sitting in equity, hold, without regard to the New York decisions, that a trustee may not, by provisions in a trust agreement, rid itself of liability for conduct inconsistent with the fundamental obligations of a trustee?

[fol. 62] 4. In the light of the statement in *Russell* v. *Todd* above quoted, is the doctrine of the New York cases cited in point 5 of the petition applicable here?

5. On the facts here, can it be said that it appears as "a legal certainty" that the jurisdictional amount is absent? Discuss the facts in the light of *St. Paul Indemnity Co.* v. *Cab Co.*, 303 U. S. 283, 288, 290 and cases there cited.

6. The court desires also to have discussed the following questions not raised by appellee in its brief or in its petition for rehearing: In the light of the discussion in *Hackner* v. *Guaranty Trust Co.*, 117 F. (2d) 95 (C. C. A. 2) of the amount of Miss York's claim, of Eastman's claim, and of the right of Eastman to continue the suit, was not the issue of the amount of Miss York's claim finally adjudicated in *Hackner* v. *Guaranty Trust Company*, *supra*, so that the present action must be dismissed for want of jurisdiction? See *Ripperger* v. *A. C. Allyn & Co.*, 113 F. (2d) 332 (C. C. A. 2). Assuming that the answer to that question should be yes if the facts here were substantially the same as those before the court in *Hackner* v. *Guaranty*, *supra*, are the facts here sufficiently different to require a different answer? In that connection, may this court consider the facts in the affidavits in the record here? May appellant be deemed to have incorporated those facts in her complaint, or may she now be allowed to amend her complaint so as to incorporate them?

Appellant may file a reply brief on or before April 24, 1944.

Learned Hand, U. S. C. J. Augustus N. Hand, U. S. C. J. Jerome N. Frank, U. S. C. J.

March 30, 1944.

[fol. 63] [Endorsed:] York v. Guaranty Trust Co. United States Circuit Court of Appeals: Second Circuit. Filed Mar. 30, 1944. Alexander M. Bell, Clerk.

[fol. 64] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

GRACE W. YORK, Plaintiff-Appellant,

v.

GUARANTY TRUST COMPANY OF NEW YORK, Defendant-Appellee

Before: L. Hand, Augustus N. Hand and Frank, C. JJ.

The opinion herein, dated March 2, 1944, is hereby recalled and the revised opinion of this date is substituted therefor. Appellee's petition for rehearing is denied. The motion of appellant for leave to file a supplemental record is denied. The petition of First National Bank of Stillwater, Oklahoma, et al. to intervene is denied without prejudice to the filing of such a petition in the district court when this case is remanded.

Learned Hand, Circuit Judge. Augustus N. Hand, Circuit Judge. Jerome N. Frank, Circuit Judge.

Filed May 25, 1944.

[fol. 65] [Endorsed:] York v. Guaranty Trust Company of New York. Order. United States Circuit Court of Appeals: Second Circuit. Filed May 25, 1944. Alexander M. Bell, Clerk.

[fol. 66] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1943

No. 256

(Argued February 1, 1944. Decided March 2, 1944
Rehearing Denied and Opinion Revised, May 25, 1944)

GRACE W. YORK, Plaintiff-Appellant,

v.

GUARANTY TRUST COMPANY OF NEW YORK, a Corporation, Defendant-Appellee

Before L. Hand, Augustus N. Hand and Frank, Circuit Judges

Appeal from a summary judgment in favor of defendant entered by the United States District Court for the Southern District of New York. Reversed and Remanded

Meyer Abrams (Chicago, Illinois) and Bennett I. Schlessel, for appellant. (Shulman, Shulman and Abrams (Chicago, Illinois, of counsel.)

Davis Polk Wardwell Gardiner & Reed (Ralph M. Carson and Francis W. Phillips, of counsel) for appellee.

[fol. 67] FRANK, Circuit Judge:

1. This case is here on appeal from a summary judgment, for the defendant, entered on the pleadings and affidavits. As a consequence some of the highly complicated facts are not entirely clear and the following statement of facts must be read with that in mind. Wherever in this opinion we refer to our conclusions "on the facts now before us" or use similar locutions, it is to be understood that we are not now making any findings, but are merely deciding that the issues of fact should be decided after the trial court hears the evidence on a trial.

Two brothers named Van Sweringen owned 80% of the stock of The Vaness Company (which we shall call Vaness). That company owned all the stock of a Delaware corporation, Van Sweringen Corporation (which we shall call the debtor), and it, in turn, owned all the stock of the Cleveland Terminals Building Company (which we shall call the sub-

sidiary). The record is silent concerning the previous history of these parties, but tells us that on May 1, 1930 (some months after the stock market debacle of 1929) the debtor issued $30,000,000 of notes payable in five years, bearing interest at 6% per annum payable semi-annually. At the time of their issuance, these notes were sold to the public by a syndicate, including the Guaranty Company of New York, a wholly-owned subsidiary of the defendant, Guaranty Trust Company of New York.

The notes were issued under an instrument executed by the debtor and the defendant which described the instrument as a "Trust Indenture" and the defendant as "the trustee." The notes were not made a lien on any assets. The Indenture contained so-called "negative pledge" clauses of a more or less conventional kind. It provided that the debtor would acquire, simultaneously with the issuance of the notes, 500,000 shares of the common stock of Alleghany Corporation which at that time had a market value of $15,000,000. [fol. 68] Such shares, and any proceeds thereof, were called "segregated assets." The debtor agreed that, until at least $15,000,000 principal amount of the notes had been retired and cancelled, the debtor would not mortgage, pledge, sell, transfer or otherwise dispose of any of the segregated assets, "except for cash, to be applied by the debtor only for the following purposes: (a) to be held as cash; (b) to retire the notes by purchase or redemption, all notes so retired to be cancelled; (c) to purchase common stock of said Alleghany Corporation; (d) to purchase United States Government obligations; or (e) to purchase and hold uncancelled in its treasury any of the notes." The Indenture provided that, whenever the aggregate value of the "segragated assets" exceeded 50% of the principal amount of all notes outstanding, the amount of such excess should no longer be subject to such restrictions and might be used by the debtor for its general corporate purposes.

There then followed provisions about which it might be said that the present suit revolves: The Indenture stated that in accordance with an agreement simultaneously executed by the trustee and the Van Sweringen brothers,[1] they agreed that, whenever the value of the "segregated assets" became less than 50% of the principal amount of

[1] That agreement was executed simultaneously with the Indenture.

all notes then outstanding, the Van Sweringens would repair such deficiency by assigning and delivering to the debtor readily marketable securities in an amount sufficient at their then market value to equal the amount of such deficiency. Such securities were referred to as "assigned securities." For the "assigned securities" the debtor was to give the Van Sweringens a non-negotiable obligation which the Van Sweringens were to hold in trust for the benefit of the holders of outstanding notes to the extent that, in the event of a liquidation of the debtor and after full distribution to the holders of the notes, a deficiency in [fol. 69] the full payment of the notes and accrued interest thereon might remain, the Van Sweringens would, to meet such deficiency, pay to the trustee for distribution to the noteholders all monies the Van Sweringens received in such liquidation on account of such non-negotiable obligation. Such "assigned securities" (subject to withdrawal provisions described below) were to be available to the creditors of the debtor for application to the payment of the debtor's liabilities; as the defendant construes the instrument, those securities (until such withdrawal) were to be the property of the debtor. The instrument contained these unusual withdrawal provisions: When $15,000,000 of the notes were retired and cancelled, then all obligations of the Van Sweringens should terminate and they were to have the right to withdraw and to have reassigned and delivered to them by the debtor all "assigned securities," on the surrender to the debtor of any obligation theretofore issued to the Van Sweringens therefor. Also, at any time before the debtor's liquidation, any excess in the "assigned securities" was to be withdrawable by the Van Sweringens.[1a]

[1a] Clause 2 of the agreement between the trustee and the Van Sweringen brothers reads as follows: "2. The Corporation shall deliver to the Van Swerngens in respect of any such assignment and delivery by the Van Sweringens to the Corporation of such readily marketable securities the stock or obligations of the Corporation. In case any such consideration consists of obligations of the Corporation such obligations shall be in non-negotiable form and shall provide that the same shall be held (except as they may be surrendered to the Corporation as hereafter provided) in trust for the benefit of the holders of said notes to the following extent, that in the event of a liquidation of the

[fol. 70] The Indenture described various "events of default," including, among others, a default in the payment of any installment of interest continuing for thirty days; a default in the provisions as to the "segregated assets" or in the negative pledge clauses; the appointment of a receiver of the debtor or of the major part of its property, or a judicial declaration that the debtor was bankrupt or insolvent. If any one or more of such events occurred, it was agreed that the trustee "may, and upon the written request of the holders of at least 25% in principal amount of the notes then outstanding, shall, declare the principal of all the notes then outstanding to be due and payable immediately, and upon any such declaration the same shall become and be due and payable immediately, anything in this Indenture or in the

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Corporation and after full distribution to the holders of said notes a deficiency in the full payment of said notes and of all accrued interest thereon remains the Van Sweringens to the extent of such deficiency on said notes pay over to the Trustee for pro rata distribution to the holders of said notes all moneys received by the Van Sweringens pursuant to such liquidation in payment of or on account of such obligations."

Clause 3, relating to the withdrawal of an excess, begins as follows: "3. All securities so assigned and delivered by the Van Sweringens to the Corporation hereunder shall, until the Van Sweringens shall be entitled to withdraw the same as hereinafter permitted, be available to *creditors* of the Corporation for application to the payment of its indebtedness and liabilities, subject, however, to the following conditions: * * * " (Italics added).

As Clause 2 relates to the rights of noteholders in particular and Clause 3 to the rights of creditors generally, there is some ambiguity in those provisions. At least for purposes of this appeal from a summary judgment, we are inclined to construe them thus: Unless, before the debtor's liquidation, the Van Sweringens had surrendered that part of the non-negotiable obligation of the debtor representing such excess, they could not, after liquidation began, withdraw such an excess until the note holders were first paid in full.

However, we shall, from time to time below, note the effect of an interpretation which would permit such withdrawal even after the beginning of liquidation.

notes contained to the contrary notwithstanding." Upon such an acceleration of the maturity of the notes, the debtor was to pay to the trustee the amount due thereon. If it did not do so, then "the trustee, in its own name and as trustee of an express trust" was empowered to institute an action at law or in equity for the amounts thus due and unpaid, to obtain a judgment in such proceedings, and to enforce any such judgment against the debtor. All rights of action under the Indenture or under any of the notes could [fol. 71] be enforced by the trustee without possession of the notes. In the event of any insolvency or bankruptcy of the debtor, the trustee was given power to execute and file proofs of debt on behalf of, and as agent of, the noteholders. The trustee was also given power to institute such proceedings as it might deem necessary or expedient "to prevent any impairment of its rights or the rights of the noteholders by any acts of the" debtor "or of others in violation of the Indenture * * * or deemed by the trustee necessary or expedient to preserve and protect its rights and the rights of the noteholders." No noteholder was to have any right to institute any action under the Indenture or for any remedy thereunder unless the holders of at least 25% of the face amount of the notes then outstanding should first have requested the trustee to act and the trustee, after a reasonable time, failed to do so. It was provided that the trustee should not be liable for anything in connection with the trust "except for its own wilful misconduct"; the Indenture contained other exculpatory clauses which we shall later discuss.

Not long after the issuance of the notes, because of a decline in the market price of Alleghany shares, the Van Sweringens delivered to the debtor, as "assigned securities," 400,000 shares of Alleghany Corporation.

In October 1930, as the time approached for the payment of the first semi-annual installment on the debtor's notes, it faced serious difficulties. Neither the debtor nor its parent Vaness had funds available to pay that interest. Moreover, because of a further decline in the market value of the Alleghany stock, the value of the 900,000 Alleghany shares, constituting the "segregated assets" and "assigned securities," threatened to sink below $15,000,000, i.e., the requisite 50% of the notes. In order to meet those difficulties and also because of grave financial problems confronting Vaness and the debtor's subsidiary, a group of

[fol. 72] banks (which we shall call the lending banks) headed by J. P. Morgan & Company (which we shall call Morgan) made two loans, one of $16,000,000 to Vaness [1a] and one of $23,500,000 to the debtor's subsidiary. The defendant, because of the interest of its subsidiary, Guaranty Company, as one of the important sellers of the debtor's notes, participated in these loans to the extent of $11,000,000. The loan to Vaness was secured by the pledge of various securities, including all the stock of the debtor, i.e., 1,744,800 shares. The loan to the debtor's subsidiary was secured by listed stocks owned by it, having a market value of $38,000,000. Part of the proceeds of the loan to Vaness was used by it to purchase $10,000,000 face amount of government bonds which were substituted for the 500,000 Alleghany shares, the "assigned securities," in this way: Vaness delivered those bonds to the Van Sweringens who delivered them as "assigned securities" to the debtor in exchange for the Alleghany stock. The Van Sweringens, in turn, delivered to Vaness the non-negotiable obligation of the debtor for $10,000,000. That obligation was pledged by Vaness to the banks which made the loan to it. $5,000,000 of the loan to the debtor's subsidiary was used to purchase government bonds which, by arrangements between the debtor and the subsidiary (not necessary to describe here) were substituted for the 400,000 Alleghany shares theretofore constituting the "segregated assets." As a result of this and other transactions, the debtor, in addition to $15,000,000 of "segregated assets" and "assigned securities" and all the stock of the subsidiary, also became the owner of an open account claim against the subsidiary in the amount of approximately $27,000,000. The November 1, 1930 interest on the notes was paid out of the proceeds of the loan to Vaness. The only debts of the debtor consisted of the $30,000,000 note issue, the subordinated obliga-[fol. 73] tion to the Van Sweringens, and a contingent liability for a maximum of $4,000,000, as guarantor of an $8,000,000 secured first mortgage bond issue of the subsidiary.[2] As the record stands, on appeal from a summary judgment,

[1a] This loan was later increased to $18,000,000.

[2] Defendant, in its brief in this court in *Hackner v. Morgan, supra*, so interpreted the maximum obligation under that guaranty.

there is no reason to believe that the debtor would ever have been called upon to pay anything on this guaranty.

During the summer of 1931, the debtor's outstanding notes fell in market value. The debtor, using part of the "segregated assets," purchased on the market some of those notes at fifty cents on the dollar and some at thirty cents on the dollar. By October 29, 1931, the debtor had thus purchased, for $1,815,057.89, notes in the face amount of $3,773,000. Had that process of buying in notes at fifty or less continued, the debtor, on acquiring $15,000,000 of such notes, would have caused them to be cancelled; thereupon the remaining "assigned securities," having a cash value of at least $7,500,000, could, under the unusual provision of the Indenture, be withdrawn by Vaness upon surrender to the debtor of its non-negotiable obligations. In that event the debtor and its creditors would lose any claim to that $7,500,000, i. e., there would be $7,500,000 less of assets available to the noteholders. The noteholders could then look only to the other assets of the debtor, which consisted of the shares of the debtor's subsidiary (which appear by that time to have become valueless) and the $27,000,000 open account claim against the subsidiary on which, so the trustee then apparently believed, the debtor would probably never recover a sufficient amount to pay more than a relatively small portion of the face of its notes. At the same time, the $7,500,000 withdrawn by Vaness, under the terms of its arrangements with the lending banks, would be paid to those banks on account of their loans to Vaness. [fol. 74] The defendant, the trustee, was fully aware of this situation. It also knew that another crisis was at hand. For it knew that the debtor had no funds with which to pay the third installment, due November 1, 1931, of interest on its notes; that the debtor's subsidiary could not supply those funds; that Vaness had no money or assets available for that purpose except $300,000 of e[illegible]s value of "assigned securities"; and that $300,000 wa[illegible]fficient to pay all the interest, which amounted to approximately $728,000.[3]

3 The Indenture did not permit the use of "segregated assets" for that purpose.

Had more than the $300,000 "excess" of the "assigned securities" been so used (assuming without deciding, that

The trustee canvassed the possibility of liquidation proceedings against the debtor, since such proceedings would stop the process of buying in notes and would prevent the withdrawal by Vaness of "assigned securities" after the reduction of the note issue to $15,000,000 which would result from such purchases if they continued. The affidavits presented by defendant on its motion for summary judgment, of the officers of the defendant and of Guaranty Company, strongly indicate that the trustee then believed that it could, and that in fact it then could, compel the debtor's liquidation in November 1931, because of the inability of the debtor to pay the November 1 interest installment due on the notes.[3a] For, if default should then occur, the trustee would have the power, under the Indenture, to accelerate the maturity of the notes, thereupon to obtain a judgment for approximately $27,000,000, and then, armed with that judgment, to cause the debtor's liquidation.

[fol. 75] Moreover, because of the sharp drop in market value of the listed stocks owned by the subsidiary, and because of the serious reduction in the value of the subsidiary's other assets (consisting principally of mortgaged real estate), the investments of the debtor in the subsidiary (which constituted the debtor's only assets other than cash in the amount of about $13,444,000) had become so reduced in value that the debtor was probably insolvent, i. e., the amount of its liabilities probably exceeded the value of its assets. Under the Delaware statutes, a receiver of a Delaware corporation which is thus insolvent may be appointed in that state at the suit of an unsecured creditor having no judgment. It may, then, be true that the trustee could have procured the appointment of a receiver for the debtor.[3b] After such appointment, the trustee, under the

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the Indenture permitted such use), there would, to that extent, have been a deficiency in such securities and the Van Sweringen brothers would have been obligated to repair that deficiency. The record more than suggests that they could not have done so.

[3a] On the present record, it would seem that the $500,000 loan, by Cleveland banks, made for that purpose could not have been obtained except as part of the offer plan described below.

[3b] This fact may appropriately be canvassed at the trial.

Indenture, could have accelerated the maturity of the notes, quite apart from any default in payment of interest.[3c]

The trustee believed that liquidation proceedings, if then begun against the debtor, would almost surely precipitate insolvency proceedings against Vaness and the debtor's subsidiary. On the facts now before us, we cannot say that the trustee did not believe that such insolvency proceedings against the subsidiary would substantially reduce the recovery by the lending banks on their $23,500,000 loan to the subsidiary. That loan was secured only by the subsidiary's listed stocks which then had a market value of only approximately $8,200,000, leaving a deficiency of more than $15,000,000. The trustee may have hoped that the market value of those listed stocks would rise to some extent so as to reduce that deficiency, and believed that, if receivership or bankruptcy of the subsidiary were then averted, its real estate would increase in value sufficiently to enable it to pay [fol. 76] some of that deficiency and also to pay something substantial on its open account claim of $27,000,000 held by the debtor.

On the facts as they now appear, if liquidation proceedings against the debtor had been instituted in 1931, all the noteholders would have received from the cash on hand at least from 42.2% to 49% of the face of their notes. For the debtor then would have had available for distribution among its creditors approximately $13,444,000 of cash (or its equivalent) consisting of "segregated assets" and "assigned securities."[4] The debtor's liabilities (ignoring the subordinated obligation to the Van Sweringens) consisted of outstanding notes, in the face amount of approximately $26,227,000, and the contingent obligation previously described. Assuming that no actual obligation would have accrued on the contingent liability, there would have been available on liquidation proceedings, before deducting expenses, sufficient to pay in cash more than 51%

[3c] At the trial, it may also be appropriate to consider whether the facts were such that the trustee could successfully have procured the debtor's adjudication in bankruptcy.

[4] This figure included the "excess" of about $300,000 of "assigned securities." As to the inability to withdraw such excess after liquidation began, see footnote 1a, *supra*.

of the face of the notes. As the debt structure of the debtor was very simple, and as its assets other than cash and government bonds consisted solely of the stock of, and the open account claim against, its subsidiary, the expense of such a proceeding, we estimate, for present purposes, as not to exceed $590,000.[4a] On that basis, the debtor's liquidation would have yielded all the noteholders at least 49% in cash. Even if we assume that the debtor would have been obliged to meet the $4,000,000 contingent liability in full, we estimate that the liquidation would have yielded, after expenses, about 42.2% in cash for all noteholders.[5] [fol. 77] The trustee decided not to bring about the liquidation of the debtor. Instead, on or about October 29, 1931, the trustee, the debtor, Vaness, Morgan and the lending banks agreed upon a plan which we shall call the offer plan. Under this plan, all noteholders were paid the 3% interest on November 1, and were offered, in exchange for their notes, 50% of the face of the notes in cash and 20 shares of the debtor's stock for each $1,000 note.[5a] The offer was to remain open until December 1, 1931.[5b] On October 29, $26,-227,000 face amount of notes were outstanding. By the terms of the offer plan, the first $11,227,000 of notes thus acquired were to be cancelled, thereby reducing the note issue to $15,000,000. Thereupon Vaness was to withdraw the remaining "assigned securities" consisting of about $7,500,000 of cash (or its equivalent) and those monies were to be used, so far as necessary, to acquire further notes from those who accepted the offer. Such notes, being purchased by Vaness, were not to be cancelled but were to remain

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[4a] In order to be conservative, we use a highly generous figure here.

[5] If, contrary to what we said in footnote 1a, the $300,000 excess were not included in the assets available on liquidation, then the above estimated percentages would be reduced to approximately 47.7% and 41.1%, respectively. On that basis, deducting the 3% interest, the non-accepting noteholders lost, under the offer plan, from 38.1% to 44.7%.

[5a] If all noteholders had accepted, they would have received in the aggregate 324,540 shares, leaving 1,419,260 or more than 80% in the hands of the lending banks as collateral. Thus the offer would not divest Vaness (or the banks as its pledgee) of voting control of the debtor.

[5b] It was later extended to December 15.

outstanding, and to be delivered to the lending banks as additional collateral security for their loans. The $300,000 of excess "assigned securities" was to be applied towards payment of the November 1 interest on the notes; the balance of the money necessary for that interest payment (estimated as "approximately $500,000") was to be procured by a loan to the debtor by certain Cleveland banks. If, after the $11,227,000 notes were cancelled, any noteholder did not accept the offer, so that, as a result some part of the $7,500,000 was not used to purchase notes, it was to be applied by Vaness first in payment of that loan by the Cleveland banks and then on account of the $1,280,000 [fol. 78] interest then due on the loan of the lending banks, no other funds for the payment of that interest being available. If there were not a sufficient balance of the $7,500,000 to pay the Cleveland banks in full, then they were to be paid out of the first amounts realized by the lending banks on the debtor's uncancelled notes which the lending banks were to receive as collateral security under the plan. The lending banks agreed to release from their collateral so much of the stock of the debtor as might be necessary to carry out the terms of offers accepted by noteholders.

Those noteholders who accepted the offer would thus receive in cash 53%, i.e., 50% principal and 3% interest. Those who did not accept would receive merely the 3% interest in cash. Thus the offer plan gave accepting noteholders from 4% to 10.8%[6] more in cash than they would have received in liquidation, i.e., 42.2% to 49%. But non-acceptors, receiving in cash only 3% interest, were, under the offer-plan, denied from 39.2% to 46% of the amount of cash they would have received on liquidation. As to the principal of their notes, they were left merely with a right to participate—as part of a class of holders of $15,000,000 of notes—in whatever the debtor might subsequently realize on the open account claim against the subsidiary. In the next year, the non-accepting noteholders received an additional 6% by way of interest. This payment reduced their loss so that, regarding solely their loss of participation in the cash assets, they lost from 33.2% to 40%.[6a]

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[6] Doubtless, too, they received this cash far more promptly than they would have receive distribution via liquidation.

[6a] Using the figures in note 5 *supra*, they lost from 32.1% to 38.7%.

If all the noteholders had accepted the offer, the only advantages to them over and above the results of liquidation, if then caused by the trustee, would have been the saving of the expense of such liquidation (and perhaps the sharing in the $300,000 excess). But the disadvantage [fol. 79] of avoiding liquidation to those who did not accept the offer would, so the trustee appears to have believed, be far greater. For the facts now before us strongly suggest that the trustee, while anticipating that, after the consummation of the offer-plan, there would be some recovery for the non-accepting noteholders, did not believe that such recovery, together with the interest they received, would amount to anything remotely approaching what they would have received on liquidation in 1931.

The trustee sent to the noteholders no information or advice concerning the offer plan. The written offer sent ~~by the~~ debtor to the noteholders was completely silent as to the existence of the loans by the lending banks, the participation of the defendant in such loans, the provision of the plan that those banks might receive part of the $7,500,000 and part of the uncancelled notes, the loan by the Cleveland banks and the arrangements for the payment of that loan, the fact that as an alternative to the offer plan the trustee could have caused liquidation of the debtor; or an estimate by the trustee of what such liquidation would have yielded.[7]

As matters worked out, the holders of all but $1,213,000 face amount of notes accepted the offer. As a consequence, there were left outstanding $15,000,000 of notes, of which $13,784,000 were, under the offer plan, delivered to the lending banks as additional collateral security. Because holders of $1,213,000 of notes did not accept, there remained, out of the $7,500,000 withdrawn cash, the sum of $606,000,[8] i. e., the 50% which would have been paid to the non-accepting noteholders if they had accepted the offer. Of this amount, approximately $500,000 was, under the plan, payable and paid to the Cleveland banks. The lending banks,

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[7] Other omissions from the offer will be noted below.

[8] In fact the withdrawn "assigned securities" amounted in cash value to approximately $7,516,000, or an excess of some $16,000 which is unexplained and which we ignore in these calculations.

[fol. 80] under the plan, were entitled to receive the balance of the \$606,000—i.e., \$106,000—to be applied on the interest on their loans. Morgan, on behalf of the lending banks, received that \$106,000, but (for reasons not appearing in the record) allowed Vaness to expend it for other purposes.[9] Accordingly, the lending banks actually received \$106,000 which apparently they could not possibly have received had the trustee instituted liquidation proceedings against the debtor in 1931.

But the offer plan might have yielded the banks far more than \$106,000. For, of course, no one knew when the offer was made, how many noteholders would not accept. Had the holders of, say, \$8,500,000, failed to accept, then, out of the \$7,500,000, of cash, there would have been left \$1,750,000 of which (after paying the Cleveland banks) the lending banks would have received not \$106,000 but \$1,250,000.

Nor can we say that the trustee did not then believe that, in addition to participation in some part of the \$7,500,000, the banks would receive other substantial advantages from the offer plan.[9a] For, at the time when the offer was made, the lending banks, including the trustee, were apparently confident that, if liquidation proceedings against the debtor did not occur and thereby insolvency proceedings against the subsidiary were prevented, the debtor would subsequently realize (on its open account claim against the subsidiary) a substantial sum. That they anticipated that this realization would be at least \$500,000 appears from the fact that the loan of the Cleveland bank could not be assured of payment unless that sum were thus realized since, if all the noteholders accepted the offer, the only source of payment of that loan would be such a realization of \$500,000. The [fol. 81] trustee knew that if a sufficient number of noteholders failed to accept, so that out of the \$7,500,000 enough cash remained to pay off the Cleveland banks, then the lending banks would, as pledgees, become the holders of at least (approximately) \$1,000,000 face amount of the \$15,000,000 notes left outstanding and that any such anticipated realiza-

[9] Included in such expenditures was an item of approximately \$53,000 paid to the Cleveland banks for monies borrowed for purposes other than paying the November 1 interest; the plan did not provide for payment of such a loan out of the \$7,500,000.

[9a] We shall later discuss still other substantial advantages.

tion of at least $500,000 would be paid, pro rata, to the banks, as such holders of notes, and the non-accepting noteholders.[10] Since the banks, as matters turned out, became the pledgee-holders of about 92% of those $15,000,000 of notes, it follows that, if the anticipated minimum of $500,000 had been realized, those banks would have received 92% of any such realization, or $460,000, while the non-accepting noteholders would have received merely $40,000, i. e., less than 4% of the face of their notes.

In fact, because of the subsequent difficulties of the subsidiary, nothing was thereafter paid on any of the outstanding notes except a payment of 6% interest in 1932. The non-accepting noteholders thus never received for their investment anything other than interest up to, and including, November 1, 1932 (i. e., interest for two and one-half years) and nothing whatsoever on the principal of their notes.

In April 1940, three of the noteholders who accepted the offer began an action against the defendant and Morgan, charging fraud and misrepresentation. Miss York, the plaintiff in the suit now at bar, subsequently tried to intervene in that action as a party plaintiff, but her intervention was denied. *Hackner* v. *Guaranty Trust Co.*, 117 F. (2d) 95 (C. C. A. 2; cert. den. 313 U. S. 559). For lack of claims in the requisite jurisdictional amount, the suit was also dismissed as to the original plaintiffs, but it was allowed to continue, under the name of *Hackner* v. *Morgan*, as to Miss [fol. 82] Eastman, an intervening accepting noteholder. In that suit, on defendant's motion, the district court entered a summary judgment for the defendants (43 Fed. Supp. 637) and we affirmed; *Hackner* v. *Morgan*, 130 F. (2d) 300 (C. C. A. 2, cert. den. 317 U. S. 691). In our opinion (based on the same affidavits, with one minor and unimportant exception, as those in the present record) we said that Miss Eastman had not shown that she suffered any loss, because had she not accepted, she would ultimately have received less than the 53% (that is 50% of the face of her notes plus 3% interest) which she obtained via the offer. We could have stopped there, but a majority of this court went on to

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[10] The lending banks, holding the greater part of the debtor's stock to secure a loan on which the interest was unpaid, presumably could have voted that stock and thus, controlling the debtor, could have compelled such payment.

say that, since there was no res, there was no trust, and that as, therefore, no breach of trust could exist, Eastman could not recover, even had a loss been proved.

Plaintiff, as the holder of notes of $6,000 in face amount, began the instant suit, making sufficient allegations of diversity of citizenship, several months after she had been dismissed as plaintiff in *Hackner v. Guaranty Trust Co., supra.* She sued on behalf of herself and other similarly situated noteholders who did not accept the offer, charging a breach by the defendant of its duties and obligations as a trustee and seeking an accounting. Both plaintiff and the defendant moved for summary judgment. On those motions, there were before the court the affidavits of George Whitney, one of the directors of the defendant, Arthur E. Burke, Vice President of the defendant, and Alfred Shriver, a Vice President of Guaranty Company.[11] The district court, relying on our statement in *Hackner v. Morgan,* held that, as here also there was no trust, no breach of trust could be found as a matter of "law," and therefore no basis for recovery existed, regardless of whether or not there was a loss. The district court accordingly entered summary judgment for the defendant.

[fol. 83] 2. In *Brooklyn Trust Company v. Kelby,* 134 F. (2d) 105, 116 (C. C. A. 2), decided after our decision in *Hackner v. Morgan,* we noted that, if the word "res" were translated as "thing," its vagueness might be more apparent, and that such a "thing" could be an intangible, as, for instance, a chose (thing) in action.[12] Subsequently, in *Clarke v. Chase National Bank,* 137 F. (2d) 797, 801 (C. C. A. 2), we held that, under a trust indenture, there could be a fiduciary relation with resultant fiduciary obligations, despite the absence of a res. We now add that where, as here, an indenture confers upon a trustee the power to

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[11] Defendant also filed an affidavit showing that the banks realized nothing on the uncancelled notes of the debtor which they received as collateral.

[12] We cited suits, *quasi in rem*, under 28 U. S. C. A. Sec. 118, such as *Omaha National Bank v. Federal Reserve Bank*, 26 F. (2d) 884 (C. C. A. 8); *Rensselaer & S. R. Co. v. Irwin*, 252 F. 921; *Thompson v. Terminal Shares*, 89 F. (2d) 652 (C. C. A. 8); *Thompson v. Murphy*, 93 F. (2d) 38 (C. C. A. 8).

sue for noteholders and other powers, the trustee holds these powers in trust.[13]

We conclude, therefore, that the defendant here was a trustee with fiduciary obligations to the noteholders.

3. Accordingly, the principal issues here are these: Did the defendant, as trustee, fail to discharge its fiduciary obligations to the non-accepting noteholders? If so, then, as a result of such conduct, did they suffer a loss?

4. We have already seen that, on the basis of the facts now before us, the defendant, in November 1931, could probably have compelled the debtor's liquidation. As will appear from our discussion below, because of the exculpatory clauses of the indenture, the defendant, absent a showing of bad faith resulting from the presence of a substantial adverse interest, would not be liable for any loss to any noteholder resulting from its failure to cause that liquidation. [fol. 84] It becomes, then, a major issue whether such a substantial adverse interest existed. The record facts sufficiently suggest its existence to render erroneous the summary judgment for defendant, but do not sufficiently demonstrate its existence to justify our directing the entry of such a judgment for plaintiff. That a trial of those issues is necessary will appear from the following.

5. The defendant, in October 1930, although not legally obligated to do so, became one of the group of lending banks. As a consequence, if the process of purchasing notes, begun in 1931, continued, the defendant, as one of the lending banks was sure to receive a substantial financial benefit through the payment by Vaness of at least \$7,500,000 on the precarious loan to it made by those banks. The defendant, therefore, occupied a dual position: If it failed to take steps, using its powers as trustee, to protect the noteholders by stopping that process of note-buying, the defendant would certainly reap a marked advantage. In such circumstances, as we shall see, the exculpatory clauses of the Indenture could not serve as a shield from liability to noteholders who sustained a loss because of its failure to take such steps.

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[13] As we observed in *Clarke* v. *Chase National Bank*, the presence of exculpatory clauses serves to emphasize the existence of a trust.

We discuss the exculpatory clauses below.

Nor would the trustee be protected because it came to occupy that dual position (through its participation in the October 1930 bank loan) in all good faith, for the best of motives, and with no expectation that a sharp conflict would ever arise between ~~the best~~ interests of the noteholders and its own self-interest. Once that conflict occurred, defendant had the obligation either to disregard what might serve its self-interest or to resign as trustee.

The defendant did not resign but, instead of then bringing about the debtor's liquidation, acquiesced in an alternative —the offer plan. If (a) this plan involved no substantial actual or potential personal benefit to the trustee, or (b) if the facts were fully disclosed to the noteholders to whom the offer was made, so that any noteholder not accepting [fol. 85] could fully have understood such actual or potential advantages to the trustee and the probable consequences of not accepting the offer, then the trustee is not liable for the loss to those who did not accept.

On the facts now before us, we cannot say that the offer plan did not involve substantial actual and anticipated potential selfish advantages to the trustee, and did not create such an adverse interest as, absent full disclosure of the facts to the noteholders, imposed liability on it for losses to non-acceptors. For, as we saw, the plan, when agreed upon, was not at all unlikely to confer benefits on the trustee, as one of the lending banks, which it could not obtain if, as trustee, it caused the debtor's liquidation. Thus, as above noted, it was then obvious that, should the holders of \$3,500,000 of notes refuse the offer, the lending banks, under the plan, would receive \$1,250,000 not available to them on the debtor's liquidation. In fact, they did receive \$106,000 under the plan. Also the trustee knew that, under the plan, those banks would in all likelihood become holders of some of the uncancelled notes [14] and that, if they did, they would subsequently share in the then anticipated minimum realization of \$500,000. Also, the trustee appears to have believed that the substitution of the offer plan for liquidation of the debtor would prevent receiverships or bankruptcy of Vaness and the debtor's subsidiary;

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[14] In fact, as we saw, they became the holders of about 92% of the outstanding notes.

if so, the plan would benefit the banks by preventing injurious effects on the loans by those banks to those companies.[14a] [fol. 86] The defendant, which denies that it derived, or stood to derive, any benefits from the plan, argues, in the alternative, that if it received any such actual or potential benefits, it gave ample consideration therefor, since, had the offer plan not arrested the process begun in 1931, of buying and cancelling notes, the lending banks, including the trustee, would have received from Vaness at least $7,500,000 of cash which Vaness would have withdrawn. But that argument lacks cogency because the defendant was not merely one of the lending banks. It was also a trustee which, as such, had the power, by forcing the debtor's liquidation, to prevent those banks from receiving any part of that $7,500,000 to the detriment of any of the noteholders.

If, contrary to what we indicated above,[14b] the $300,000 excess in the "assigned securities" could have been withdrawn by Vaness after the institution of liquidation proceedings against the debtor, then that sum would have gone to the banks on liquidation. On that assumption, the banks under the offer plan gave up a right to $300,000 and, therefore, the $106,000 was not a benefit which they obtained by that plan. Even so, however, the plan, when agreed upon, was not unlikely to yield them other substantial advantages, above described, which could not have come to them on liquidation. They might well have obtained considerably more than $300,000 through the plan, and the plan prevented receiverships of Vaness and of the subsidiary, with advantages to the banks of the kind above described.

The trustee could have blocked the offer plan by insisting on the debtor's liquidation. If, then, the trustee had de-

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[14a] The plan would leave the lending banks with voting control of the debtor; see footnotes 5a and 10. It would also probably give, and in fact did give, those banks more than 75% of the outstanding notes, thus preventing the non-accepting noteholders from procuring the demand by 25% necessary to compel action by the trustee against the debtor of a kind which would precipitate insolvency proceedings against Vaness and the subsidiary.

[14b] See footnote [1a].

sired to avoid liquidation and, at the same time, to avoid, as far as possible, benefits to itself at the expense of those noteholders who would not accept the offer, it could, and would, have said to Vaness and the other lending banks that it would allow the plan to go through only if modified [fol. 87] as follows: The first payment, out of (a) any balance of the $7,500,000 not needed to pay accepting noteholders and the Cleveland banks and (b) any subsequent realizations by the debtor, must be paid to non-accepting noteholders until they received at least 50% of the face of their notes,[14c] and only then should anything be paid from either of those items to the lending banks.[14d] Such a step would, on the facts before us, seem to be the least the trustee should have done to protect the non-assenting noteholders, although it may be doubted whether, on the facts as they now appear, such a modification of the plan would have purged the plan of impropriety by the trustee since, even thus modified, the plan would have benefited the lending banks by preventing the subsidiary's receivership. But even that step the trustee did not take.

In sum, the facts now before us (which may appear to be decidedly different after a trial) more than suggest that the trustee may have believed that, under the offer plan, non-accepting noteholders would receive very substantially less than they would have received through liquidation (which the trustee could then have compelled) and that the trustee may have known that it probably stood personally to gain substantial advantages, as one of the lending banks, which it could not obtain if such liquidation then occurred.

Of course, the courts should not impose impractical obligations on a trustee. Merely vague or remote possible selfish advantages to a trustee are not sufficient to prove such an adverse interest as to bring his conduct into question. But here the advantages seem not to have been thus

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[14c] Or, at least as much as they would have received on liquidation, using some reasonable estimated figure.

[14d] If the lending banks were entitled to the $200,000 "excess," then it would have been proper to provide that they should receive that sum before any payments were made to non-accepting noteholders.

[fol. 88] vague or remote.[15] That a trustee owes his beneficiaries undivided loyalty entirely untinged by considerations of any important benefits to himself is an old truth, and one whose edge cannot be dulled by frequent use.[15a] If the trustee here allowed its judgment to be affected by any such factors, it acted improperly. Cf. *Pepper* v. *Litton*, 308 U. S. 295, 311. If it failed to exercise the powers it held in trust because it entertained a belief that such inaction might be to its own substantial benefit (while failing to consider the consequent harm to any of its beneficiaries) then it breached its obligations, regardless of whether its belief, objectively viewed, was illusory. That is to say, the

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[15] Our comments in *Irwin* v. *Simmons*, 140 F. (2d) 558, 560-562 (C. C. A. 2), are not in point here. For defendant here is a trustee repeatedly designated as such in the notes and the indenture. The indenture vests in the trustee all rights of action; it provides that such actions shall be brought "in its name as trustee," and that the trustee "in its name and as trustee of an express trust" shall be entitled to sue for collection of all amounts due the noteholders.

[15a] Chief Justice Stone has said that this principle embodies "the precept as old as Holy Writ, that 'a man cannot serve two masters' * * * No thinking man can believe that an economy built upon a business foundation can long endure without loyalty to that principle." Stone, *The Public Influence of the Bar*, 48 Harv. L. Rev. 1, 8.

In *Bayer* v. *Bevan*, N. Y. L. J. April 20, 1944, Mr. Justice Shientag said: "The fiduciary has two paramount obligations: responsibility and loyalty * * * They lie at the very foundation of our whole system of free private enterprise and are as fresh and significant today as when they were formulated decades ago * * * While there is a high moral purpose implicit in this transcendent fiduciary principle of undivided loyalty, it has back of it a profound understanding of human nature and of its frailties. It actually accomplishes a practical beneficent purpose. It tends to prevent a clouded conception of fidelity that blurs the vision. It preserves the free exercise of judgment uncontaminated by the dross of divided allegiance or self-interest. It prevents the operation of an influence that may be indirect but that is all the more potent for that reason."

trustee should be held liable[15b] if the trial court reasonably infers from the evidence at the trial that the trustee, [fol. 89] in making its decision, was moved to do so in any degree by the thought that it might incidentally secure a substantial advantage to itself. In such circumstances, nothing would turn on the fact that the trustee did not in fact derive benefits, if its inactivity caused loss to any of its beneficiaries. Nor is it relevant that the great majority of the beneficiaries fared better through such inaction. The trustee owed an equal duty to all its beneficiaries; cf. Restatement of Trusts, s. 183. Those who suffered have a right to demand that the trustee put them in the financial position which they would have occupied, had it acted for the equal benefit of all. If the trustee is liable here, the measure of its liability is the loss suffered by the non-accepting noteholders, not the benefits derived by the trustee.

6. Even if, however, the plaintiff on the trial, proves that the trustee stood to gain substantially from its inaction (or thought that it did) and that the non-accepting noteholders lost by that inaction, the trustee will have a good defense if it proves that a full disclosure of the pertinent facts was made to them before the offer expired on December 15, 1931. We are not to be taken as holding that in all circumstances a trustee with an adverse interest can exculpate himself by disclosure to his beneficiaries; we limit that ruling to the facts of this case as they now appear. On the record, as it now stands, we cannot say that the requisite disclosure was made.

We turn first to the terms of the offer.[15c] It stated the amount of notes outstanding and the amount of cash available. It disclosed that the Indenture permitted the Van [fol. 90] Sweringen brothers to withdraw all "assigned securities" after $15,000,000 of notes were retired; that the debtor believed that the offer would be "mutually bene-

[15b] Subject to the qualifications noted later in this opinion.

[15c] The offer, signed by the debtor, was sent by the debtor or by investment bankers to the noteholders. There is nothing, we repeat, in the record to show that the trustee gave the noteholders any data or advice concerning the offer.

ficial" to accepting noteholders and to the debtor; that the November 1, 1931 interest would "be paid in the usual way on presentation" of coupons; and that, under the offer plan, notes purchased after the retirement of $15,000,000, would be acquired "not by the corporation but by the Van Sweringen interests," and would "remain outstanding on a parity as obligations" of the debtor with notes held by non-accepting noteholders. The offer also stated that acceptors would receive not only 50% in cash (in addition to 3% interest) but would receive some of the shares of the debtor. Nothing whatever was said in the offer to indicate that these shares were virtually without value, although such appears to have then been the belief of the trustee.

If the shares of the debtor thus offered to the accepting noteholders, had any value whatever, then, even after the acceptance of the offer by enough of the noteholders to permit the cancellation of $15,000,000 of notes and the withdrawal of all the remaining cash (i. e., $7,500,000), the remaining assets of the debtor must have been sufficient to pay all the non-accepting noteholders in full, for, otherwise, the stock would be worthless. Consequently, the offer of those shares to accepting noteholders might have led the ordinary wayfaring noteholder to believe that, if he did not accept the offer, the debtor's assets would be ample to pay him one hundred cents on the dollar. Thus the offer, on its face, did not in any way disclose the difficulties which the trustee then thought were in store for a non-accepting noteholder.

The defendant, however, argues that the noteholders were put on notice that the debtor's shares at that time lacked value, because the offer advised them that balance-sheets of the debtor and its subsidiary would "be furnished on request." We assume, arguendo, that this statement [fol. 91] served to give all the noteholders all the information they would have gleaned had they called for and read those balance-sheets. Any noteholder who did so, would have seen that the debtor apparently had $69,000,000 of assets to cover both the $26,246,000 of notes (plus interest thereon) and the contingent liability of not to exceed $4,000,000, or far more than enough assets, aside from the cash on hand, to meet all its debts (disregarding the subordinated obligations to the Van Swering[illegible]ns). Put on notice of those facts, the noteholder would still have assumed that, if he refused the offer and if all the cash then

on hand were paid out, he would be no worse off than if he accepted the offer.

The defendant correctly asserts that a close study of the balance-sheets would have revealed the worthlessness of the debtor's shares.[15d] But we cannot agree with defendant that such a study would also have shown that one who did not accept the offer would not be nearly as well off as one who did. The debtor's balance-sheets showed that among its assets were the shares of its subsidiary carried on the debtor's balance-sheet at cost, or approximately $29,000,000. Alongside this figure, a notation advised that it was based on book-values of the subsidiary's real estate and of the cost of securities owned by the subsidiary, without giving effect to "adjustment in market values of listed securities owned by subsidiary," in this connection calling attention to the balance-sheet of the subsidiary.

Turning now to the subsidiary's balance-sheet, it showed that, among its assets, were "listed stocks" carried at cost, or approximately $37,200,000. A footnote showed that these stocks, pledged to secure a $23,500,000 note, had on September [fol. 92] ber 30, 1929, been worth approximately $93,000,000; on September 30, 1930, approximately $38,000,000; and, that on September 30, 1931 (the date of the balance-sheet) they had a market value of only (approximately) $8,200,000. Here was a disclosure that these securities, at then market values, were worth approximately $29,000,000 less than their cost. The subsidiary's total assets were shown as approximately $103,000,000, so that, deducting the $29,000,000 shrinkage in the listed stocks, the subsidiary's assets appeared to be about $74,000,000. Against this asset figure, were shown liabilities aggregating approximately $76,000,000. A noteholder who sent for, and carefully read, the balance-sheets would, then, have seen that, on the basis of the then low market values of the listed stocks owned by the subsidiary, the debtor's shares were worthless and that the investment of the debtor in the shares of the subsidiary—approximately $29,000,000—had no value.

[15d] In making that contention, defendant is driven to admit that the offer was misleading since it included an offer of shares hopelessly without value, unaccompanied by a clear explanation of that fact. The defendant, on the facts before us, did nothing to aid the noteholders to discover that fact.

On the other hand, although the subsidiary's debts were shown to exceed its assets, yet, according to the balance-sheet the proportion of assets to debts was such that the debtor's $27,000,000 open account claim against the subsidiary appeared to be worth at least $15,000,000.[15e] On that basis, after the offer plan was consummated, the debtor would have sufficient assets to pay the full face of its then outstanding $15,000,000 of notes; even if the debtor were [fol. 93] liable in full, on its $4,000,000 contingent liability, so that its liabilities would be $19,000,000, it would have enough assets to pay more than 78% on the face of those notes. A noteholder might, therefore, reasonably have thought that he would be no worse off if he did not accept the offer.

Nothing in the offer intimated in any way that serious shrinkage in the value of the subsidiary's real estate assets of which the trustee, according to the affidavits filed by it, then had a lively awareness. No adequate warning of this fact was given by the notations, in the subsidiary's balance-sheets, that its land and building were carried at cost or on the basis of appraisals. True, attached to the balance-sheet was an income statement, for the first nine months of 1931, which showed a net loss for that period (after deducting depreciation) of approximately $1,633,000. This loss (resulting from an excess of operating expenses, taxes and fixed charges over rentals received) would serve to indicate that there was a lack of net earnings on the improved real estate of the subsidiary for the preceding nine months. But that fact would not alone seem sufficient to suggest that so much of the subsidiary's assets as consisted of real estate had so seriously shrunk in value as to reduce the value of the $27,000,000 open ac-

[15e] If the figure of $37,200,000, representing the listed stocks, were deducted from the assets, but the entire $23,500,000 note secured by those stocks were still included in the liabilities, there would be assets of about $65,000,000 to cover about $76,000,000 of liabilities (including the liability on the $27,000,000 open account owing to the debtor). Those figures indicated that the open account claim was worth about $23,000,000. We shall not here attempt a nicer analysis but, in order to be conservative, we assume that the open account claim appeared, from the balance-sheet, to be worth at least $15,000,000.

count claim owing to the debtor to less than, say, $11,000,000, i. e., a sum more than sufficient to yield 53% of the notes which would be outstanding if the offer transaction were carried out (even assuming that the debtor would be held fully liable on the $4,000,000 contingent liability).

Accordingly, on the facts now before us, there was no adequate disclosure to a noteholder that, in the trustee's opinion, if he did not accept the offer and other noteholders did accept in a sufficient amount to reduce the note issue to $15,000,000, in all probability he would recover very substantially less than if he accepted. Nor was he told [fol. 94] that liquidation of the debtor presented an alternative to the offer plan[16] but that such liquidation, in the opinion of the trustee, would be somewhat less advantageous to him than acceptance of the offer but far more advantageous than its rejection. Nor was there a syllable to suggest that the trustee was one of a group of banks which had loaned large sums to the debtor's parent, Vaness, and to the debtor's subsidiary; that, under the offer plan, those lending banks, including the trustee, might reap substantial advantages which they would never obtain if the debtor were liquidated through proceedings then begun; and that, inter alia, those notes purchased under the offer plan which were not to be cancelled would be received by those banks as collateral.

We think that in the circumstances (assuming that the trustee had a substantial adverse interest), it could have avoided liability for loss to the non-accepting noteholders only by a disclosure, in clear terms, of the nature of that interest, of the alternative of liquidation together with a statement of what the trustee regarded its probable consequences, and of facts showing why, in the trustee's opinion, the acceptance of the offer promised to be more beneficial to noteholders than its rejection. On the present record, nothing like such a disclosure was made. If, then, the plaintiff, at the trial, proves that the defendant was in any degree actuated by a substantial adverse interest and the defendant fails to adduce evidence of a more adequate

[16] As a matter of fact that alternative had disappeared on November 14, 1931, about two weeks after the offer was made; for by that date, as enough notes had been bought and cancelled, the note issue was reduced to $15,000,000 and, accordingly, Vaness then withdrew the $7,500,000.

disclosure than that contained in the offer, balance-sheets and income statement, plaintiff must win.

Had the trustee in 1931 caused the debtor's liquidation, the liquidation of the subsidiary (so defendant's affidavits more than suggest) would soon have followed. There [fol. 95] might have resulted a substantial recovery on the open account claim against the subsidiary. While it is arguable that that recovery, on the facts before us, would perhaps not have yielded the noteholders an amount which, together with their participation in the cash assets then in the debtor's hands, would have equalled the 53% offered under the plan, it might well have given them in excess of 50%, although apparently the trustee did not think so. What that recovery might have been, no one now can estimate with any high degree of accuracy. But, if defendant wrongfully failed to bring about that liquidation, it cannot avail itself of the resulting difficulty of making that estimation. "The wrongdoer is not entitled to complain that" the damages "cannot be measured with the exactness and precision that would be possible if the case, which he alone is responsible for making, were otherwise," for "the risk of the uncertainty should be thrown upon the wrongdoer instead of upon the injured party. * * *" *Story Parchment Co.* v. *Patterson Co.*, 282 U. S. 555, 563, 564-565.[18]

7. Defendant in its petition for rehearing for the first time asserted that, on the face of the complaint, it appears that the court lacks jurisdiction because plaintiff's claim, exclusive of interest and costs, does not exceed $3,000. That contention requires defendant to show that it is a "legal certainty" that the plaintiff's claim is below the required figure. See *St. Paul Indemnity Co.* v. *Cab Co.*, 303 U. S. 283, 288-290, and cases there cited. The absence of such a "legal certainty" is indicated by the fact that, until it filed its rehearing petition, defendant did not even suggest that defense.

[fol. 96] It is true that, if defendant's loss related solely to the loss of participation in the cash assets which would

[18] See also, *Great Southern Gas & Oil Co.* v. *Logan Natural Gas & Fuel Co.*, 155 F. 114, 115 (C. C. A. 6) cert. den. 207 U. S. 590); *Lincoln* v. *Orthwein*, 120 F. 880, 886 (C. C. A. 5); *Package Closure Corp.* v. *Sealright Corp.*, — F. (2d) — (C. C. A. 2, April 3, 1944); cf. *F. W. Woolworth* v. *N. L. R. B.*, 121 F. (2d) 658, 663 (C. C. A. 2).

have been available for distribution had liquidation occurred in 1931; her claim would probably not be in excess of $3,000.[19] But, as we have said, she suffered an additional loss of participation in what might have been recovered on the open account claim against the debtor's subsidiary, if liquidation had then occurred. That loss is of such a character that, when added to the loss of participation in the cash, it cannot be said that it is a legal certainty that plaintiff's claim is for less than $3,000.

Defendant urges that, if we conclude here that plaintiff's claim is for more than $3,000, our conclusion will be inconsistent with what we said as to the amount of recovery in *Hackner v. Guaranty Trust Co.*, 117 F. (2d) 95 and *Hackner v. Morgan*, 130 F. (2d) 300. For reasons which we need not here set forth, we think there is no such inconsistency. But, assuming arguendo that there is, yet we are not bound here to abide by our previous conclusion, if, when upon a

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[19] However, it might be said that, in computing the amount of plaintiff's claim, interest may be included. Interest on her notes is represented by matured coupons, and such interest could be added for jurisdictional purposes in an action against the debtor. *Edwards v. Bates County*, 163 U. S. 269. Perhaps that decision should be disregarded here, since it might be urged that plaintiff is not suing on her notes and coupons as such but is proceeding against the trustee for a loss which plaintiff suffered, measured by the amount which she could have recovered from the debtor but for defendant's wrongdoing. Even so, there could well be considered the doctrine of *Brown v. Webster*, 156 U. S. 328, i. e., that in an action for a tort there is to be included, in computing the jurisdictional amount, interest which forms part of the damages and which therefore becomes "an essential ingredient in the * * * principal claim. * * *" See also *Springstead v. Crawfordsville State Bank*, 231 U. S. 541, 542; *Chesbrough v. Northern Trust Co.*, 252 U. S. 83; *Chesbrough v. Woodworth*, 251 F. 881, 883 (C. C. A. 6); *Central Commercial Co. v. Jones-Dusenbury Co.*, 251 F. 13, 17 (C. C. A. 7); *Intermela v. Perkins*, 205 F. 603, 606 (C. C. A. 9); *Nathan v. Rock Springs Distilling Co.* 10 F. (2d) 268 (C. C. A. 6); *Simecek v. U. S. National Bank of Omaha*, 91 F. (2d) 214, 217, 218 (C. C. A. 8).

searching examination of the facts, it appears to us to be [fol. 97] incorrect; even if the statements in our earlier opinions were the "law of the case," we would not be obliged to stand by them when convinced of their error.[20]

8. It has been suggested, however, that our decision as to plaintiff's attempted intervention in *Hackner v. Guaranty Trust Co.*, 117 F. (2d) 95 (C. C. A. 2) is an adjudication that the amount in controversy is not in excess of $3,000 and that therefore the court below, the very court in which *Hackner v. Guaranty Company* was brought, lacked jurisdiction here. In *Hackner v. Guaranty Trust Co.*, the action was begun by noteholders who had accepted the offer and who sought recovery against Guaranty Trust in deceit because of alleged false representations which induced them thus to accept. None of the noteholders who instituted that action had a claim in the jurisdictional amount. Plaintiff endeavored to intervene. On motions by defendants to dismiss the complaint and deny the intervention, the district court, on the pleadings, entered judgment for the defendants and we affirmed. Miss York's attempted intervention in that suit, based upon deceit, should be regarded, and was indeed by us there regarded, as, in effect, an action by her for recovery on the ground of deceit inducing her acceptance of an offer which in fact, according to her petition of intervention, she had not accepted. We there decided that, although she held notes in the amount of $6,000, her claim, on the facts alleged, was for not more than $3,000 and, on that ground, we held that she had been properly denied intervention. That decision on the pleadings in such an action was not an adjudication that, in a suit based on a different theory—i. e., the defendant's breach of its fiduciary obligations in not causing the debtor's liquida- [fol. 98] tion—her claim was not for the requisite amount.[21]

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[20] See *Messenger v. Anderson*, 225 U. S. 436, 444; *Riehle v. Margolies*, 279 U. S. 218, 220 *et seq.*; *Cadillac Motor Car Co. v. Johnson*, 261 F. 878 (C. C. A. 2); *Hammond-Knowlton v. U. S.*, 121 F. (2d) 192, 205 (C. C. A. 2).

[21] Cf. discussion of res judicata in *Southern Pacific Railway Co. v. Bogert*, 250 U. S. 483, 490-491.

This too should be noted: As appears from *Ripperger v. A. C. Allyn*, 113 F. (2d) 332 (C. C. A. 2) and *Smith v. McNeal*, 109 U. S. 426, a prior decision dismissing a suit

9. Defendant also relies on the exculpatory clauses of the indenture.[22] The provision that the "trustee may advise with counsel * * * and shall be fully protected in respect [fol. 99] of any action taken or suffered * * * in good

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on the mere pleadings for lack of jurisdiction is not a bar to a second suit alleging sufficient jurisdictional facts which existed when the first suit was pending but which were not therein alleged. Cf. *Wiggins Ferry Co.* v. *O. & M. Railway*, 142 U. S. 396, 410; *Sylvan Beach* v. *Koch*, 140 Fed. (2d) 852, 860 (C. C. A. 8); *Dennison Mfg. Co.* v. *Scharf Tag, Label & Box Co.*, 121 F. 313, 318 (C. C. A. 6). It is by no means clear that the facts alleged in *Hackner* v. *Guaranty Trust Co.* bearing on plaintiff's participation in the recovery from debtor's subsidiary are substantially similar to those which appear in the present record if we include defendant's affidavits. If necessary, plaintiff could amend, either here or in the district court, when the case is remanded, to include in her complaint that portion of the facts contained in defendant's affidavits bearing on her participation in such recovery. 28 U. S. C. A. §777; F. R. C. P. 15(c); *Smith* v. *McCullough*, 270 U. S. 456, 460; *Realty Holding Co.* v. *Donaldson*, 268 U. S. 398, 400; *Norton* v. *Larney*, 266 U. S. 511, 516; *Mexican Cent. R. Co.* v. *Duthie*, 189 U. S. 76; *Kinney* v. *Columbia Savings & Loan Assn.*, 191 U. S. 78, 83; *Thompson* v. *Automatic Fire Protection Co.*, 151 F. 945; *Whalen* v. *Gordon*, 95 F. 305, 307 (C. C. A. 8); *In re Plymouth Cordage Co.*, 135 F. 1000, 1003 (C. C. A. 8); *Gregg* v. *Gier*, Fed. Cas. No. 5, 799; *Missouri, Kansas & Texas Ry. Co.* v. *Wulf*, 226 U. S. 570, 576; *Atwood* v. *National Bank of Lima*, 115 F. (2d) 861, 863 (C. C. A. 6); *N. Y. Cent. R. R.* v. *Kinney*, 260 U. S. 340, 346; *Matty* v. *Grasselli Co.*, 303 U. S. 197, 200-201; *U. S.* v. *Memphis Cotton Oil Co.*, 288 U. S. 62, 68-69.

But, for the reasons stated in the text, while it is perhaps desirable that plaintiff should thus amend when the case is remanded, such an amendment is not necessary to avoid defendant's *res judicata* argument.

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[22] Each note expressly refers, six times, to the defendant as "trustee." There is not a syllable in the notes suggesting that the trustee is to be immunized from the usual obligations of a trustee, but the notes state that they are is-

faith in accordance with the opinion of such counsel,'' has no application here, for no facts are shown indicating that, in failing to cause liquidation and in participating in the offer plan without full notice to all noteholders, the defendant acted on advice of counsel. The provisions that the trustee might purchase or own or hold any of the notes and ''assert its rights in respect thereof in the same manner as any other noteholder,'' and engage in any financial transaction with the debtor or any corporation in which the debtor may be interested, did no more here than permit defendant to become a noteholder and a creditor of the debtor's subsidiary. It did not authorize defendant, when in that position, to subordinate the interests of any of the noteholders to its own.

Defendant stresses the provision that the trustee shall not be ''answerable * * * for anything whatever in connection with this trust except for its own wilful misconduct,'' and cites New York decisions said to be pertinent here. We cannot agree. The case on which defendant chiefly relies is *Hazzard* v. *Chase National Bank*, 159 Misc. 57 (aff'd. 257 App. Div. 950, 282 N. Y. 652), where the trust indenture provided that the trustee should not be answerable ''under any circumstances whatsoever, except for its own gross negligence or bad faith.'' The trustee had made large unsecured loans to the obligor, its officers, and affiliated companies. The indenture permitted the obligor to withdraw securities pledged with the trustee and to substitute others provided the earnings, applicable to pay the interest under the indenture from all the securities remaining on deposit with the trustee after the substitution, for a certain period preceding the application for substitution, was at least twice the interest requirements for a period of one year. The plaintiff contended that the defendant was guilty of bad faith in permitting certain substitutions; it argued that the purpose of the

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sued ''under and pursuant to an Indenture * * * to which * * * reference is hereby made for a description of the terms on which such notes are issued and of the rights of the Trustee and of the holders of the notes under said Indenture. * * *'' While the average noteholder, we know, as a matter of common knowledge, never reads such an indenture, yet all the noteholders are bound by its terms so far as they are valid.

[fol. 190] trustee in permitting them was to enable the obligor to use the withdrawn collateral for the purpose of meeting the interest requirements on the debentures secured by the indenture, thus preventing the otherwise inevitable default in the payment of this interest in order to keep the obligor alive for six months during which time the trustee would be able to collect or protect its loans to the obligor and affiliated companies and to the officers of the obligor. The Court found as a fact that the plaintiffs had "not sustained the burden of proving that the trustee sought to obtain profit for itself at the expense of its debenture-holders by its action in allowing the substitution, or that it was actuated in any way by bad faith." It found that the purpose of the withdrawal, so far as the trustee was concerned, was the furtherance of an expansion policy of the obligor and its affiliated companies and that there was "nothing to show" that the trustee "had any knowledge of any insincerity in these alleged * * * policies." On the facts, the Court also found that the trustee was not guilty of gross negligence. In the instant case, the issue is not that of defendant's negligence but whether defendant was guilty of "wilful misconduct" which we take to be the equivalent of "bad faith." The *Hazzard* case, where the findings of fact on that issue turned on the particular record evidence, has no precedential force here.[23] For

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[23] In *Benton* v. *Safe Deposit Co.*, 255 N. Y. 260, a suit against a trustee under a mortgage executed in Pennsylvania which provided that the trustee should not be liable "save for its gross negligence or wilful default," and that it "shall be no part of the duty of the trustee to record this instrument," the mortgage not having been recorded and the notes not having been paid, a noteholder sued the trustee for the resulting loss. The Court, finding that under Pennsylvania decisions a trustee in such circumstances would not be liable, held for the defendant, saying that there was no such fundamental injustice in the exculpatory clauses as to forbid enforcement of them in New York as against the State's public policy. The Court, quoting from a Pennsylvania decision that such a noteholder could easily have learned of the non-recording, said, "The plaintiff could have ascertained all the facts upon inquiry; nothing was hidden or concealed." In *Savings Bank of New Lon-*

here, on the facts now before us (which, we repeat, must be [fol. 101] canvassed after a trial), it may appear that the defendant knowingly failed to take action and by so doing injured plaintiff, although defendant knew that such inaction and the concomitant plan would probably operate to the defendant's own substantial advantage.

10. The parties stipulated that plaintiff's notes "were originally acquired by the firm of Warren W. York & Company" and that "on April 19, 1934, the plaintiff received said notes as a gift and she has been the owner and holder thereof since that date." Defendant made nothing of these facts in the court below nor here until it filed its petition for rehearing. Then it urged that, under New York decisions,[24] only the person who owned the notes at the time when the breach of trust occurred can maintain an action because of such breach since the action does not involve any charge of releasing any trust assets on which the notes were [fol. 102] a lien. The New York cases seem so to hold. But they recognize that the cause of action may be specifically assigned.[25] If plaintiff here obtained her notes upon the dissolution of the firm, such an assignment to her may have

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don v. *New York Trust Co.*, 27 N. Y. S. (2d) 963, the indenture provided that the trustee should not be "answerable or accountable under any circumstances except for bad faith." The trustee released part of the mortgaged property without receiving in return the money received by the mortgagor for such property. The Court held that the trustee was grossly negligent but that, on the facts before it, there was no showing of bad faith. In *Ansbacher* v. *New York Trust Co.*, 280 N. Y. 79, the court held that, on the particular facts stated in the pleadings, the trustee was not guilty of gross negligence or bad faith; those facts are wholly unlike those before us. On its facts, *Green* v. *Title Guarantee & Trust Co.*, 223 App. Div. 12, is not in point.

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[24] *Elkind* v. *Chase National Bank*, 259 App. Div. 661, aff'd. 284 N. Y. 726; *Emmerich* v. *Central Hanover Bank & Trust Co.*, 291 N. Y. 570; *Hendry* v. *Title Guaranty & Trust Co.*, 225 App. Div. 497, aff'd. 280 N. Y. 740; *Doyle* v. *Chatham & Phenix National Bank*, 253 N. Y. 369; *Smith* v. *Continental Bank & Trust Co.*, N. Y. (April 6, 1944).

[25] *Smith* v. *Continental Bank & Trust Co.*, *supra*.

been implied in fact. At any rate, on a motion for summary judgment, we cannot hold that she did not acquire the notes by an actual assignment, express or implied in fact. When the case is remanded, plaintiff may amend to set forth the actual facts concerning the assignment, and of course defendant will be at liberty to try to show that there was no express assignment or none implied in fact.[26]

11. Plaintiff alleges in her complaint that she did not learn of the trustee's participation in the 1931 offer plan until "the middle of 1940" when she sought to intervene in the *Hackner* v. *Guaranty Trust* action. As previously noted, an order denying her intervention in that action was affirmed by this court. That action terminated as to her on April 7, 1941, when certiorari was denied in 311 U. S. 559. She began the present suit on January 22, 1942.

Defendant argues that, because of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, we must apply the New York statute of limitations as construed by the New York courts; that this action, if brought in a New York court, could have been brought at law; that it is therefore barred by the New York six-year statute, Civil Practice Act § 48 subdivision 3 relat- [fol. 103] ing to such suits; that, if it be considered as being exclusively within the equity jurisdiction, it is nevertheless barred by the ten-year provision of § 53 of that Act which the New York courts have held applicable to equity suits of that kind; that the New York courts have decided that, under § 53, the statute is not tolled even if, because of defendant's misconduct, plaintiff was in ignorance of her rights until after the lapse of the ten years; that the only provision of the New York statute which makes allowance for such ignorance is subdivision 5 of § 48 which relates

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[26] This disposition of defendant's contention renders it unnecessary to consider the following suggestion: Restrictions on the bringing of stockholders' actions, such as those imposed by F. R. C. P. 23(b) or state statutes, are procedural [cf. *Piccard* v. *Sperry Corp.*, 120 F. (2d) 328 (C. C. A. 2, affirming 36 F. Supp. 1006); *Galdi* v. *Jones*, — F. (2d) — (C. C. A. 2, April 4, 1944); *Towner-Hill Connellsville Coke Co.* v. *Piedmont Coal Co.*, 64 F. (2d) 817, 828 (C. C. A. 4, cert. den. 290 U. S. 675], and the restriction imposed by the New York courts on suits by assignees of notes is similar.

solely to "an action to procure a judgment on the ground of fraud," and that the New York courts have interpreted that section to apply exclusively to actions for deceit and the like. In short, defendant contends that, under New York law, and therefore in a federal court sitting in New York, a suit by a beneficiary against a trustee for breach of trust, unless it is the equivalent of an action for deceit, is barred at least after ten years, regardless of the fact that, due to the trustee's inequitable conduct, the beneficiary was ignorant of the cause of action until after the fixed statutory period. Assuming, arguendo, that defendant's interpretation of the New York decisions is correct, we reject defendant's contention for the following reasons.

Beginning in 1818 with Chief Justice Marshall's opinion in *Robinson* v. *Campbell*, 3 Wheat. 212, 222,[27] the Supreme Court has repeatedly held that, while as to substantive rights, a federal court sitting in equity, in a suit where juris- [fol. 104] diction rests on diversity of citizenship, must apply state statutes and, usually, state decisions, yet it need not do so with respect to equitable "remedial rights."[28]

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[27] In *Robinson* v. *Campbell, supra,* the Court, explaining this doctrine, said: "In some states in the Union, no court of chancery exists, to administer equitable relief. In some of those states, courts of law recognise and enforce, in suits at law, all the equitable claims and rights which a court of equity would recognise and enforce; in other, all relief is denied, and such equitable claims and rights are to be considered as mere nullities, at law. A construction, therefore, that would adopt the state practice, in all its extent, would at once extinguish in such states, the exercise of equitable jurisdiction."

[28] The progeny of *Robinson* v. *Campbell* are legion. See, e. g., *U. S.* v. *Howland*, 4 Wheat. 108, 115; *Boyle* v. *Zacharie*, 6 Pet. 532, 648, 658; *Livingston* v. *Story*, 9 Pet. 532, 535; *Neves* v. *Scott*, 13 How. 268, 272; *Payne* v. *Hook*, 7 Wall. 425, 430; *Kirby* v. *Lake Shore & M. S. R. Co.*, 120 U. S. 130; *In re Sawyer*, 124 U. S. 200, 209-210; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 204; *Guffey* v. *Smith*, 237 U. S. 110, 114; *Pusey & Jones* v. *Hanssen*, 261 U. S. 49; *Henrietta Mills* v. *Rutherford*, 281 U. S. 121, 127; *Atlas Ins. Co.* v. *Southern Co.*, 306 U. S. 563, 568; *Sprague* v. *Ticonic Bank*, 307 U. S. 161, 146; cf. *Mason* v. *U. S.*, 260 U. S. 545, 557-558.

As to substantive rights, beginning in 1842—twenty-four years after *Robinson* v. *Campbell*—with *Swift* v. *Tyson*, 16 Pet. 1, the Court held, until recently, that the federal courts, in diversity cases, must follow state decisions except where there is no pertinent state statute and where a question of "general law" is involved. *Swift* v. *Tyson* was a suit at law, and its ruling was founded upon an interpretation of the so-called Rules of Decision Act, being § 34 of the Judiciary Act of 1789, now 28 U. S. C. A. § 725. That section, by its terms, applies only to suits at common law; but it has been held to be merely declaratory of the rule which would obtain even in the absence of such a federal statute and which therefore governs in equity as well as at law.[29]

Erie v. *Tompkins* came to destroy the exception created by *Swift* v. *Tyson*, and did so both in law and equity suits.[30] But it did not purport to, and it did not, in any way alter the wholly distinct doctrine relating to equitable "remedial rights",[31] which rests on § 11 of the Judiciary Act, now 28 U. S. C. A. § 41(1), conferring equity powers on the federal [fol. 105] courts.[32] There can be no doubt that today, as

[29] *Mason* v. *U. S.* 260 U. S. 545, 559 and cases there cited.

[30] *Ruhlin* v. *New York Life Ins. Co.*, 304 U. S. 202.

[31] See, e. g., *Kelleam* v. *Maryland Casualty Co.*, 312 U. S. 377; cf. *Sprague* v. *Ticonic Bank*, 307 U. S. 161; *Atlas Ins. Co.* v. *Southern Co.*, 306 U. S. 563.

[32] In *Atlas Ins. Co.* v. *Southern Co.*, 306 U. S. 563, 568, the court, referring to this section, said: "This provision is perpetuated in § 24(1) of the Judicial Code, 28 U. S. C. § 41(1), which declares that the district courts shall have jurisdiction of such suits. The 'jurisdiction' thus conferred on the federal courts to entertain suits in equity is an authority to administer in equity suits the principles of the system of judicial remedies which had been devised and was being administered by the English Court of Chancery at the time of the separation of the two countries. *Payne* v. *Hook*, 7 Wall. 425, 430; *In re Sawyer*, 124 U. S. 200, 209-210; *Matthews* v. *Rodgers*, 284 U. S. 521, 525; *Gordon* v. *Washington*, 295 U. S. 30, 36. This clause of the statute does not define the jurisdiction of the district courts as federal courts, in the sense of their power or authority to hear and

before *Erie* v. *Tompkins*, a federal court sitting in a given state will, for instance, refuse to appoint a receiver at the suit of an unsecured creditor although the statute of that state authorizes such an action,[33] or will grant equitable relief to a lessee under an oil and gas lease containing a clause giving the lessee an option of surrender although the court refuses such relief.[34]

[fol. 106] The point of this discussion is that it has often been held that, for the purposes of this doctrine, state statutes of limitations are to be regarded in the federal courts as affecting not substantive rights but merely equitable "remedial rights."[35] The Supreme Court so held in the leading case of *Kirby* v. *Lake Shore & M. S. R. Co.*, 120 U. S. 130, an equity suit brought in the federal district court in

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decide, but prescribes the body of doctrine which is to guide their decisions and enable them to determine whether in any given instance a suit of which a district court has jurisdiction as a federal court is an appropriate one for the exercise of the extraordinary powers of a court of equity."

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[33] *Pusey & Jones* v. *Hanssen*, 261 U. S. 491; *Kelleam* v. *Maryland Casualty Co.*, 312 U. S. 377.

[34] *Guffey* v. *Smith*, 237 U. S. 101. There the Court said: "By the legislation of Congress and repeated decisions of this court it has long been settled that the remedies afforded and modes of proceeding pursued in the federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules and usages of equity having uniform operation in those courts wherever sitting. Rev. Stat. §§ 913, 917; *Neves* v. *Scott*, 13 How. 268, 272; *Payne* v. *Hook*, 7 Wall. 425, 430; *Dodge* v. *Tulleys*, 144 U. S. 451, 457; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 204. As was said in the first of these cases, 'Wherever a case in equity may arise, and be determined, under the judicial power of the United States, the same principles of equity must be applied to it, and it is for the courts of the United States, and for this court in the last resort, to decide what those principles are, and to apply such of them, to each particular case, as they may find justly applicable.' "

[35] Cf. the conflict of laws doctrine that statutes of limitation, in general, pertain to procedure. Goodrich, *Conflict of Laws* (1927) 168.

New York, and based on the concurrent equity "jurisdiction." The lower court had held that it was bound by the New York statute, that the suit was not one within the statutory provision relating to an action "to procure a judgment * * * on the ground of fraud," as that provision had been construed by the New York courts, and that consequently the cause of action accrued upon the commission of the alleged frauds and not at the date of their discovery, with the result that the action was barred by the statute after the lapse of six years. The Supreme Court rejected that argument based upon the statute. After citing cases, including *Robinson* v *Campbell, supra*, the Court said (p. 138): "In view of these authorities, it is clear that the statute of New York upon the subject of limitation does not affect the power and duty of the court below—following the settled rules of equity—to adjudge that time did not run in favor of defendants, charged with actual concealed fraud, until after such fraud was or should, with due diligence, have been discovered. Upon any other theory the equity jurisdiction of the courts of the United States could not be exercised according to rules and principles applicable alike in every state. It is undoubtedly true, as announced in adjudged cases, that courts of equity feel themselves bound, in cases of concurrent jurisdiction, by the statutes of limitation that govern courts of law in similar circumstances, and [fol. 107] that sometimes they act upon the analogy of the like limitation of law. *But these general rules must be taken subject to the qualification that the equity jurisdiction of the courts of the United States cannot be impaired by the laws of the respective states in which they sit.*"[35a] We see nothing to indicate that the doctrine of the *Kirby* case has been over-ruled or modified by *Erie* v. *Tompkins*.

Russell v. *Todd*, 309 U. S. 28, decided since the *Tompkins* case, was a suit in equity, brought in a federal district court in New York to enforce the individual liability of shareholders of a Federal Joint Stock Land Bank. The defendant argued that the action was barred by the New York 3-year statute of limitations relating to suits to enforce liabilities of stockholders. The court held that the suit was one exclusively of "equitable cognizance, in that it is not predicated upon any legal cause of action," and that, as ~~the New York courts had decided that the 3-year statute did~~

[35a] Emphasis added.

not apply to such an equity suit, it did not govern in the federal courts. As the only New York limitations provisions applicable to such an equity action was the ten-year statute and as less than ten years had run, the Court said that it had no occasion to consider the question before us in the instant case. But, in the course of its opinion, the Court reviewed the previous decisions, saying that, though not regarding themselves as bound by state statutes of limitations, federal equity courts will nevertheless, when "*consonant with equitable principles,*"[36] adopt as their own a local statute of limitations applicable to similar equitable causes of action; that when the equitable jurisdiction of the federal court is concurrent with that at law, or when the suit is brought in aid of a legal right, equity will withhold its remedy if the legal right is barred by the local statute; and [fol. 108] that where the equity jurisdiction is exclusive, state statutes barring action at law, are inapplicable. In its discussion, the Court made the following significant comment (309 U. S. 288, note 1): "But federal courts of equity have not always held themselves bound to follow local statutes which in ordinary circumstances they could adopt and apply by analogy. In each case the refusal has been placed upon the ground of *special equitable doctrines making it inequitable to apply the statute. * * * Federal courts of equity have not considered themselves obligated to apply local statutes of limitations when they conflict with equitable principles, as where they apply, irrespective of the plaintiff's ignorance of his rights because of the fraud or inequitable conduct of the defendant.*" (Citing, inter alia, the *Kirby* case.)[37]

That the doctrine of federal court independence concerning equitable "remedial rights" is distinct and apart from that of *Swift* v. *Tyson*, which *Erie* v. *Tompkins* over-ruled, clearly appears from the fact that Mr. Justice Brandeis, the arch enemy of *Swift* v. *Tyson*, enthusiastically endorsed the "remedial rights" doctrine in *Pusey & Jones* v. *Hanssen*, 261 U. S. 491,[38] which cited with approval *Guffey* v.

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[36] Emphasis added.

[37] Emphasis added.

[38] In *Pusey & Jones* v. *Hanssen*, an unsecured creditor, who filed a bill in a federal court seeking the appointment of a receiver for a corporate debtor, relied on a state stat-

Smith, 237 U. S. 101, 114, one of the leading cases upholding that doctrine.[39] Mr. Justice Holmes who, in *Kuhn* v. *Fairmont*, 215 U. S. 349, 370, had sharply criticized *Swift* v. *Tyson*, five years later concurred in *Guffey* v. *Smith*, and [fol. 109] eight years after that decision concurred in *Pusey & Jones, supra*.[40] That Mr. Justice Brandeis in no wise objected to the extension of the "remedial rights" doctrine to state limitations statutes appears from his opinion, for the Court, in *Benedict* v. *New York*, 250 U. S. 321, 327-328, where he cited the *Kirby* case with approval.[41] We find it

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ute which expressly authorized such an action. The Court, in explaining why such relief must be refused despite the state statute, reviewed the previous decisions and gave a masterful exposition of the distinction between substantive and equitable remedial rights.

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[39] See also *Shapiro* v. *Wilgus*, 287 U. S. 356, in which Brandeis, *J.*, concurred.

[40] That these concurrences cannot be explained as a subsequent acquiescence in *Kuhn* v. *Fairmont* appears from the fact that, thirteen years after *Guffey* v. *Smith* he again, in his dissenting opinion in *Black & White Taxicab Co.* v. *B. & Y. Taxicab Co.*, 276 U. S. 518, 532, vigorously objected to the *Swift* v. *Tyson* doctrine. Brandeis, *J.*, concurred in that dissent. Two years later, both those Justices concurred in *Henrietta Mills* v. *Rutherford*, 281 U. S. 121, 127-128, where the distinction between substantive and equitable "remedial" rights was reiterated and a state remedial statute was again ignored.

[41] There, in a suit to enforce an express trust, he said: "Under the law of New York the alleged cause of action would have been subject, if not to the six-year statute of limitations (New York Code of Civil Procedure, § 382), then to the ten-year statute of limitations (New York Code of Civil Procedure, § 388), governing bills for relief in cases of the existence of a trust not cognizable by the courts of common law. *Clarke* v. *Boorman's Executors*, 18 Wall. 493. If the Act of 1874 created an express trust, the statute of limitations would not begin to run until there had been a repudiation of the trust. *New Orleans* v. *Warner*, 175 U. S. 120, 130. Here there was an open repudiation of the trust duties which the plaintiff now seeks to enforce. And seventeen years were allowed to elapse after that re-

impossible to believe that, speaking for the Court, he in-[fol. 110] tended to over-rule *Kirby* and *Pusey & Jones* in *Erie* v. *Tompkins* which nowhere mentions those cases or the doctrine which they embody.

Failure to observe the distinction between that doctrine and the *Swift* v. *Tyson* doctrine leads defendant to make the erroneous suggestion that in *Ruhlin* v. *New York Life Ins. Co.*, 304 U. S. 202 (decided a week after *Erie* v. *Tompkins*) the court, by implication, held that the *Tompkins* case had obliterated the precedential value of cases like *Kirby*; and that therefore the remarks of the Chief Justice in the later case of *Russell* v. *Todd* were in error, or, at best, "merely part of an historical conspectus" superfluously recalling abandoned precedents. In the *Ruhlin* case, the court vacated a judgment and remanded because, in a suit in equity, the lower federal court had, a la *Swift* v. *Tyson*, construed an "incontestability clause" of a life insurance policy according to "general" or "federal" law and not with reference to the law of the state in which the federal district court was located. Thus that case merely applied the *Tompkins* rule to substantive rights when involved in equity cases. The Court had no occasion to consider, and the opinion did not, therefore, discuss, the question whether, the substantive rights being settled according to state decisions, the federal court should grant equitable relief of a

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pudiation before this suit was begun and more than ten years before any attempt was made to secure some settlement by negotiation; and there clearly was no waiver of the statute. While it is true that federal courts sitting in equity are not bound by state statutes of limitations (*Kirby* v. *Lake Shore & M. S. R. Co.*, 120 U. S. 130), they are, under ordinary circumstances, guided by them in determining their action on stale claims. *Godden* v. *Kimmell*, 99 U. S. 201, 210; *Philippi* v. *Philippe*, 115 U. S. 151; *Pearsall* v. *Smith*, 149 U. S. 231; *Alsop* v. *Riker*, 155 U. S. 448. Compare *Sullivan* v. *Portland & Kennebec R. Co.*, 94 U. S. 806, 811. Between 1892 and 1905 plaintiff did nothing to enforce his alleged rights except to commence in 1893 a suit which he did not prosecute. His lack of diligence is wholly unexcused; and both the nature of the claim and the situation of the parties was such as to call for diligence. The lower courts did not err in sustaining the defense of laches."

kind other than that granted in the state courts.[42] Accordingly, it left untouched the settled doctrine as to equitable remedial rights; and, as no question of limitations was involved in *Ruhlin*, that case did not even intimate that the matter of limitations was no longer to be regarded as affecting such remedial rights. It is significant that, after [fol. 111] the *Ruhlin* case, the Court, in *Sprague* v. *Ticonic Bank*, 307 U. S. 161, 164, cited with approval *Robinson* v. *Campbell* and other other similar subsequent cases, and that later, in *Kelleam* v. *Maryland Casualty Co.*, 312 U. S. 377, 381, the Court cited and followed *Pusey & Jones* v. *Hanssen*.[43] *Ettelson* v. *Metropolitan Life Insurance Co.*,

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[42] The same is true of *New York Life Ins. Co.* v. *Jackson*, 304 U. S. 261; *Rosenthal* v. *New York Life Ins. Co.*, 304 U. S. 263; *Kellogg Co.* v. *National Biscuit Co.*, 305 U. S. 111; *Wichita Royalty Co.* v. *City National Bank*, 306 U. S. 103, 107; *Cities Service Co.* v. *Dunlap*, 308 U. S. 208; *Fidelity Trust Co.* v. *Field*, 311 U. S. 169; *West* v. *American Tel. & Tel. Co.*, 311 U. S. 223, 236; *Stoner* v. *New York Life Ins. Co.*, 311 U. S. 464; *Griffin* v. *McCoach*, 313 U. S. 498; *Pecheur Co.* v. *National Candy Co.*, 315 U. S. 666; and *Meredith* v. *Winter Haven*, 320 U. S. 228.

In *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447, in a suit at law, the Court held that *Erie* v. *Tompkins* was not applicable because the plaintiff was a federal corporation suing under a federal statute which provided that all suits to which that corporation was a party "shall be deemed to arise under the laws of the United States." The majority of the Court did not consider alternative grounds for its decision noted by Mr. Justice Jackson, i. e., that *Erie* v. *Tompkins* did not apply because jurisdiction was not founded upon diversity of citizenship or perhaps because the defense of equitable estoppel might be considered "an equity matter" although the action was at law. That the majority of the Court did not rely upon the doctrine relating to remedial rights when "equitable estoppel" was involved is no indication that it obliterated that doctrine.

[43] In *Black & Yates* v. *Mahogany Ass'n*, 129 F. (2d) 227, 233 (C. C. A. 3, cert. den. 317 U. S. 672) the Court said: "The rule of *Erie* v. *Tompkins* being determinative of substantive rights, there is still preserved a uniform basis for granting equitable remedies in cases in which substantive rights have arisen under state law."

317 U. S. 188 teaches that the new Rules have not obliterated the distinction between actions at law and suits in equity.

It may be that equity jurisdiction in the instant case is exclusive and not concurrent. Which it is, must be determined not by New York but by federal decisions as to the federal equity jurisdiction existing at the time of the adoption of the Constitution or of the enactment of the Judiciary Act of 1789.[44] At that date, an action against a trustee for breach of trust seems to have been within the [fol. 112] exclusive cognizance of equity.[45] And it would seem that the "jurisdiction" of such a suit is not to be regarded as "concurrent" for the purposes here under discussion, even if the beneficiary can sue at law.[46] Doubtless a trustee may make a contract imposing upon him legal

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[44] See, e.g., *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 206; *Petroleum Co.* v. *Commissioner*, 304 U. S. 209, 217; *Russell* v. *Todd*, 309 U. S. 280, 286; *Stratton* v. *St. L. & S. W. Ry.*, 284 U. S. 530, 533, 540; *Matthew* v. *Rodgers*, 284 U. S. 521, 529; *Gordon* v. *Washington*, 295 U. S. 30, 37; *Waterman* v. *Canal-Louisiana Bank Co.*, 215 U. S. 33, 43; *Sprague* v. *Ticonic Bank*, 307 U. S. 161, 163-164; *Pennsylvania* v. *Wheeling Bridge Co.*, 13 How. 518, 563; *Payne* v. *Hook*, 7 Wall. 425, 430; cf. *Rules of Equity Practice*, 7 Wheat. xvii, Rule xxxiii.

Of course, Congress can change the scope of the equity jurisdiction; *Sprague* v. *Ticonic Bank*, *supra*.

[45] See 3 Halsbury's *Laws of England* (2d ed.) 305.

See also *Alexander* v. *Hillman*, 296 U. S. 222, 239; *Clews* v. *Jameson*, 128 U. S. 461, 479; 1 Pomeroy, *Equity Jurisdiction*, 654-687.

[46] The mere fact that the claim against a trustee is for money does not render the jurisdiction concurrent. See, e.g., *Taylor* v. *Benham*, 5 How. 232; *Bay State Gas Co.* v. *Rogers*, 147 F. 557, 560-561.

The Restatement of Trusts, § 197, says that "except as stated in § 198, the remedies * * * are exclusively equitable"; the remedies described in § 198 do not include a suit to "compel the trustee to redress a breach of trust" which is included, as an "equitable" remedy in § 199(c); and § 201 defines a breach of trust as a violation of "any duty" which the trustee "owes to the beneficiary."

obligations on which he may be sued on the "law side". But his obligations, qua trustee, are presumably still purely equitable in the federal courts, no matter how much he may modify them by contract.

It is, however, of no moment whether here the "jurisdiction" is or is not exclusively equitable.[47] For the *Kirby* case (cited with approval in *Benedict* v. *New York*, supra, and *Russell* v. *Todd*, *supra*) was a case of concurrent jurisdiction; yet the Court held that, if the defendant's misconduct prevented the plaintiff from learning his rights, the New York statute of limitations should be disregarded. Accord- [fol. 113] ingly, whether the equity jurisdiction is exclusive or concurrent, the court, where the defendant is guilty of "inequitable conduct" causing plaintiff's ignorance of his rights will toll the statute. In all the cases cited in *Russell* v. *Todd*, in which, where the equity jurisdiction was concurrent, the Court applied the local limitations statute,[48] either (a) there was no showing whatever of any

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In *Miles* v. *Vivian*, 79 F. 848 (C. C. A. 2), the trustee was found guilty of negligence. The Court held that jurisdiction in equity as to such a breach of duty was concurrent and that therefore the statute of limitations would apply, especially as the plaintiff had long slept on his rights and showed no excuse for having done so. In *Frismuth* v. *Farmers Loan & Trust Co.*, 107 F. 169 (C. C. A. 2) again the action was for negligence on the part of the trustee. Here the basis of the action is not negligence but knowing failure to act where the trustee had a conflicting interest and plaintiff has not slept on her rights.

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[47] That if the suit is of exclusively equitable cognizance the federal court will, when equitable considerations exist, disregard a state statute specifically applicable thereto, see cases cited in *Russell* v. *Todd* (309 U. S. at 288 note 1) such as *Alsop* v. *Riker*, 155 U. S. 448; *Patterson* v. *Hewitt*, 195 U. S. 309, 318; *Kelley* v. *Boettcher*, 85 F. 55, 62 (C. C. A. 8).

[48] *Wilson* v. *Koontz*, 7 Cranch 202; *Stearns* v. *Page*, 7 How. 818, 830-831; *Clarke* v. *Boorman*, 18 Wall. 505, 507; *Carol* v. *Green*, 92 U. S. 509; *Godfrey* v. *Terry*, 97 U. S. 175; *Baker* v. *Cummings*, 169 U. S. 189, 206-207; *Metropolitan Bank* v. *St. Louis Dispatch Co.*, 149 U. S. 436, 448-449; *Wood* v.

inequitable conduct of the defendant accounting for plaintiff's ignorance of his rights or (b) the plaintiff, after becoming aware of his rights, slept on them.[18a]

[fol. 114] Nor is it true, as defendant contends, that the federal courts have applied the *Kirby* doctrine only in or-

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Carpenter, 101 U. S. 135; *Hughes* v. *Reed*, 46 F. (2d) 435 (C. C. A. 10); *Wagner* v. *Baird*, 7 How. 234; *Godden* v. *Kimmel*, 99 U. S. 201. See also *Speidel* v. *Henrici*, 169 U. S. 206-207; *Curtis, Receiver* v. *Connly*, 257 U. S. 261.

[18a] In *Roos* v. *Texas*, 126 F. (2d) 767 (C. C. A. 5) there was no showing of plaintiff's "ignorance of his rights because of the fraud or inequitable conduct of the defendant" and the opinion discloses that plaintiff was clearly chargeable with laches.

In *Shultz* v. *Manufacturers & Traders Trust Co.*, 128 F. (2d) 889, we held the New York limitations statute to be applicable to a suit for damages, accounting and other relief for an alleged conspiracy and fraud in defendant's acquisition of stock from plaintiff's decedent. But there the trial court had made explicit findings, which a majority of this court held amply supported by the evidence, that the decedent had known, or reasonably should have known, all the facts at or about the time of the alleged wrongdoing. True, our opinion stated that "no ground was shown for purely equitable relief," and, in that connection, relied not on federal but on New York decisions, and the opinion also said that in *Russell* v. *Todd* the court "was ready to accept an explicit applicable state statute applicable to a suit of an exclusively equitable cognizance." As the plaintiff, on the findings, was there chargeable with the grossest delay, those portions of our opinion were in no way necessary to the decision, and we do not feel bound by them here where the facts are very substantially different. See *Cohens* v. *Virginia*, 6 Wheat. 264, 399; *Taylor* v. *Voss*, 271 U. S. 176, 184; *Weyerhaeuser* v. *Hoyt*, 219 U. S. 380, 394.

The doctrine of those cases last cited applies to *Union Mutual Life Ins. Co.* v. *Friedman*, 139 F. (2d) 542 (C. C. A. 2). There we held that, in a suit for recovery of moneys paid out because of defendant's fraudulent misrepresentations, defendant could not be deprived of a jury trial by

der to shorten the time within which the claim is barred because a plaintiff delays his suit without excuse. The opinion in the *Kirby* case itself shows that the rule has not been so limited as to favor only defendants, but works both ways.[49] See also Vandevanter, *J.*, in *Stevens* v. *Grand Central Mining Co.*, 113 F. 28, 32 (C. C. A. 8);[50] Sanborn, *J.*, in *Wilson* v. *Plutus Mining Co.*, 174 F. 317, 320-321 (C. C. A. 8).

It follows that, while we are bound by the interpretation which New York decisions give to the trust indenture, we are not required to apply the New York statute of limitations if there are strong countervailing equitable considerations. On the facts now before us, we cannot say that

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treating the suit as one in equity. We said that it was not sufficient that the New York statute of limitations might bar recovery at law and might not in equity. As the record in that case shows, the facts were such that the effect of the statute was the same at law or in equity, i.e., the statute in any event did not run until the discovery of the fraud.

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[49] In the frequently cited case of *Kelley* v. *Boettcher*, 85 Fed. 55, 62, (C. C. A. 8), Judge Sanborn said: "In the application of the doctrine of laches, the settled rule is that Courts of equity are not bound by but that they usually act or refuse to act in analogy to, the statute of limitations relating to actions at law of like character. * * * The meaning of this rule is that, under ordinary circumstances, a suit in equity will not be stayed for laches before, and will be stayed after, the time fixed by the analogous statute of limitations at law; but if unusual conditions or extraordinary circumstances make it inequitable to allow the prosecution of a suit after a briefer, or to forbid its maintenance after a longer period than that fixed by the statute, the chancellor will not be bound by the statute, but will determine the extraordinary case in accordance with the equities which condition it."

Cf. *Cooper* v. *Hill*, 94 F. 582, 589-591 (C. C. A. 8); *Chiswell* v. *Johnston*, 299 F. 681, 688 (App. D. C.); *Johnston* v. *Roe*, 1 F. 692; *Tice* v. *School District*, 17 F. 283 (C. C. D. Neb.); *Johnson* v. *White*, 39 F. (2d) 793, 798 (C. C. A. 8).

[50] Cited with approval in *Russell* v. *Todd*, *supra*.

defendant's conduct, which apparently led to plaintiff's ignorance of her rights, was not clearly "inequitable."
[fol. 115] We conclude, then, that we cannot sustain the summary judgment on the ground that the action was barred by limitations or laches.[51]

12. Plaintiff prayed for relief on behalf of herself and all similarly situated noteholders. Defendant, on this appeal, urges that no such relief can be granted. Although that issue will not directly arise unless and until the trial court decides that defendant wrongfully caused a loss to non-accepting noteholders, we think it will, in the light of the protracted history of this litigation and the fact that the question has been argued before us, to indicate our views.

Rule 23(a) reads as follows: "If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued when the character of the right sought to be enforced for or against the class is (1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it; (2) several, and the object of the action is the adjudication of claims which do or may affect specific property involved in the action; or (3) several, and there is a common question of law or fact affecting the several rights and a common relief is sought." The complaint adequately states the common interest of all the non-accepting noteholders and that they are so widely scattered as to make it too ex-
[fol. 116] pensive to join them all as parties.[52] On the facts

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[51] Plaintiff alleges that, when she first learned of the cause of action she tried to intervene in *Hackner* v. *Guaranty Trust Co.* That attempted intervention, although based on an erroneous theory, was enough to rebut laches. *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, 490-491; cf. *N. Y. Cent. R. Co.* v. *Kinney*, 260 U. S. 340, 346; *U. S.* v. *Memphis Cotton Oil Co.*, 288 U. S. 62, 68-69; *Matty* v. *Grasselli Co.*, 303 U. S. 197, 200-201.

[52] After the case is remanded, the defendant, of course, may, if it sees fit, traverse these allegations and try to show that plaintiff does not adequately represent the absent noteholders. However, this should be noted: The plaintiff does

alleged, all non-accepting noteholders suffered losses through a common breach of trust consisting of improper non-action by their common trustee. To be sure, the trustee may perhaps be able to show, as a defense, that, even if some of these noteholders had not sufficient knowledge of the facts, others who may intervene were aware of those facts, so that their loss did not flow from the trustee's inadequate disclosure. But such facts, if proved, will be by way of defense.[53] The claims here are not individualized fraud claims based upon individual misrepresentations. This action may, therefore, be maintained as a class suit under Rule 23(a) (3).[54]

But it is obvious that such a ruling may be purely academic and lack all practical significance unless any other noteholder who intervenes will, for purposes of the defense [fol. 117] of laches, have the benefit of the date when plaintiff attempted to intervene in *Hackner v. Guaranty Trust*

not need to include the claims of others in order to maintain federal jurisdiction. As the suit comes within Rule 23(a) (3), so that a judgment will not be res judicata as to noteholders who do not intervene, there is no necessity for a searching inquiry concerning the adequacy of her representation of others in the class.

[53] The defendant may have other defenses against specific intervenors.

[54] In *Hackner v. Guaranty Trust Co.*, 117 F. (2d) 95 (C. C. A. 2), Hackner and the other noteholder plaintiffs (except York who was dismissed as plaintiff) had accepted the offer, alleging that they had been induced by misrepresentations to part with their notes and had thereby suffered losses. As each such accepting noteholder, in order to recover, needed to show that he, individually, had acted in reliance on alleged misrepresentations, we held that, for purposes of establishing the requisite jurisdictional amount, the claims of the several plaintiffs could not be aggregated. Cf. *Central Mexico Light & Power Co. v. Munch*, 116 F. (2d) 85, 89 (C. C. A. 2). For the Rules could not affect basic jurisdictional requirements fixed by statute. But there were no similar inhibitions as to changes affecting loss of rights through lapse of time, as indicated by Rule 60(b).

Co.[54a] Before the new Rules, that question seems not to have been considered as to suits of the kind now described in 23(a) (3), but it was several times answered in favor of intervenors in class suits of the character now described in 23(a) (1) and (2). *Richmond* v. *Irons*, 121 U. S. 27, 54; *Marsh* v. *United States*, 97 F. (2d) 327, 330 (C. C. A. 4); *Newgate* v. *Atlantic & D. R. Co.*, 72 Fed. 712, 716; *Dobson* v. *Simonton*, 93 N. C. 268, 271-273.[55] In the case last cited, the court said: "It would be a strange anomaly in the law, if it should allow an action to be brought for a party, and he should thus be encouraged to rely upon it, and not seek legal redress otherwise than by it, and yet when he came, in the course of his action, to prove his debt, and share in the fund, to treat him as having, by such reliance, lost it by the lapse of time happening after the bringing of the action. The law will not mislead—it is just and faithful, and will not tolerate, much less uphold, a rule of practice that works such injustice and absurdity." We think those comments are apposite here. We agree with *Deckert* v. *Independence Shares Corp.*, 39 Fed. Supp. 592, 597[56]—seemingly the only case discussing the problem, and one which is cited and quoted with apparent approval in 2 Moore, Federal Practice, 1942 Supplement, p. 99[57]—that Rule [fol. 118] 23(a) makes no differentiation, for purposes of limitations (and therefore of laches), between class suits under (1), (2) and (3). As to suits under (3), no less than those under (1) or (2), the Rule unequivocally tells all per-

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[54a] See footnote 51a. The complaint in that suit, brought by accepting noteholders, prayed relief on behalf of all others similarly situated. Her intervention should be deemed to have adopted that prayer *vis a vis* non-accepting noteholders.

[55] Cf. *Southern Pacific Co.* v. *Bogert*, 250 U. S. at 489-490.

[56] There the court, considering the suit, in the alternative, either as under 23(a) (2) or (3), held that there was no difference in this respect.

[57] The same discussion (relating to intervention under Rule 24) appears in Moore's 1943 Supplement, page 105. Earlier, in 1938, before the *Deckert* case, Moore, in his comments on dismissal of class actions under Rule 23(c), had expressed a different view (Volume 2, page 2280, note 11); however, in his annotation in his 1943 Supplement, page

sons having claims of the type therein described that one or more of them may begin such a class action "on behalf of all" when the "class" is "so numerous as to make it impracticable to bring them all before the court." Any non-accepting noteholders, relying on that assurance, were justified in believing that plaintiff's suit was begun on their behalf although they were not before the court. To hold that such noteholders cannot, as to lapse of time, have the benefit, by intervention, of the institution of the suit by plaintiff would be to convert the Rule into a trap. Since, in a class suit under clause (3), a judgment will not be res judicata for or against those of the class who do not intervene, we suggest that if, after trial, the court finds against the defendant, appropriate steps be taken to notify all such noteholders to intervene (if they have not theretofore done so), judgment to be entered in favor only of those who do so within a reasonable time. Those who do intervene will be no more barred by lapse of time than is the plaintiff, unless defendant can prove special facts affecting them.

Reversed and remanded.

[fol. 119] AUGUSTUS N. HAND, *Circuit Judge* (dissenting):

Upon reconsideration of this case on the petition for rehearing, I have become convinced that we seriously erred in our original decision. I can see no reason to suppose that the Guaranty Trust Company was guilty of a breach of any fiduciary relation which it assumed under the trust indenture.

In Article Four, Section 22, dealing with "Remedies on Default", the trust indenture provided that in the event of any of the defaults enumerated "* * * the Trustees may, and upon the written request of the holders of at least twenty-five per cent in principal amount of the notes then

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84, to that earlier comment, he makes a cross-reference to his more recent discussion of the *Deckert* case.

As Moore states, that decision was reversed "on other grounds" in *Pennsylvania Co. For Insurance etc. v. Deckert*, 123 F. (2d) 979 (C. C. A. 3). There, as to limitations, the court, as we read its opinion, held merely that, in a clause (3) suit, the claim of an intervenor is barred if, before the institution of that suit, the statute had run against his claim.

outstanding, shall, declare the principal of all the notes then outstanding to be due and payable immediately, and upon any such declaration the same shall become and be due and payable immediately, anything in this indenture or in the notes contained to the contrary notwithstanding."

In Article Seven, Section 33, the indenture provided that: "The Trustee shall not be answerable for * * * anything whatever in connection with this trust except for its own wilful misconduct"; also that: "Anyone holding the office of Trustee hereunder may from time to time purchase, acquire, hold, own and deal in any of the notes and may assert its rights in respect thereof in the same manner as any other noteholder hereunder. The Trustee or any company in which it or its stockholders may be interested or affiliated, or any officer or director of the Trustee or of any such company, may acquire and hold any of the notes and coupons, or may engage in or be interested in any financial or other transaction with the Company or any corporation in which the Company may be interested * * *".

Under the foregoing provisions there was no duty on the part of the trustee to declare or to procure a default, even though it might hold an adverse interest, as a creditor [fol. 120] of the debtor, to some of the noteholders. The indenture gave the trustee the right to become a creditor. To procure a general liquidation by declaring a default would have been in the interest of no one connected with the enterprise, for all of the noteholders would have been likely to obtain less for their claims than by proceeding with the 50% plan offered by the debtor at the instigation of the trustee. It is doubtless true that the trustee could not refrain from exercising any right it had to declare a default in order to secure an advantage to itself at the expense of the noteholders. But I think there is no reason to suppose that it did refrain for any such reason. If it had not promoted the making of the 50% offer to the noteholders and had allowed matters to drift and the debtor to continue to purchase the notes at 50 cents on the dollar or less, as it was doing, the lending banks, of which the trustee was one, would have received some $7,500,000 of cash from Vaness instead of the relatively trifling sum which came to them out of the balance of moneys arising from the failure of the non-assenting note-holders to accept the offer. That it arranged to have the 50% offer made and thus sought to protect the interests of the noteholders showed

its honest purpose. It seems impossible to suppose that a plan which yielded the banks only $106,000, and that because the non-assenting noteholders declined to accept it, was entered into in order that the banks should make money at the expense of any of the noteholders. I can see no duty to declare a default merely because the trustee, as a lender, had an interest in not having a default declared. The trust instrument gave the trustee the right to become such a lender and yet explicitly made the exercise of the power to declare a default permissive and discretionary. The Guaranty Trust Company was acting for the noteholders as a whole and if liquidation rather than acceptance of the plan would injure all of them, I can see no obligation to liquidate to the injury of the majority merely because some [fol. 121] noteholders failed to accept when acceptance was to their advantage as well as to that of all the other noteholders and the lending banks. I do not think that a disclosure of the loans which the trustee was permitted to make under the trust indenture was either necessary or relevant to the only problem the non-accepting noteholders had which was whether or not to accept an offer that the debtor correctly advised them was to their advantage. To justify the plaintiff's claim on the merits we must regard the promotion of the 50% offer, the trustee's procurement of an extension of time to accept it beyond the original acceptance date, and the acceptance of the offer by 96% of the noteholders, as insufficient to show good faith on the part of the trustee. I think these factors negative any inference that the failure of the trustee to give explicit information as to the probability of serious loss to non-acceptors was in the hope that noteholders would refuse to accept and thus bring some advantage to the lending banks.

But aside from any question as to the merits of plaintiff's claim, I see no sufficient reason for not holding it barred by the New York statute of limitations, under which claims like the one sued on here would be barred if not asserted within ten years after they had accrued. Since the rule announced in *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, and *Ruhlin* v. *New York Life Insurance Co.*, 304 U. S. 202, became law, I think the situation is most rare when we should disregard the local statute of limitations because the proceeding is equitable. This seems implicit in the decision in *Russell* v. *Todd*, 309 U. S. 280, and while, because of the footnote to the opinion found at page 288, it seems probable

that equitable claims may be asserted in extreme situations even if the local statute of limitations has expired, I cannot believe that the present is such an occasion. Any fault here lay in the omission of the trustee to warn the plaintiff of the loss she would incur if she failed to accept the [fol. 122] debtor's offer. That I regard as at most an act of negligence which was something far different from a deliberate concealment in order to prevent the non-accepting noteholders from bringing suit. The plaintiff here must have known she had suffered a loss which she would not have suffered if she had accepted the offer. She also was bound to know that the trustee had a right to have an interest either as a noteholder or lender in the assets of the debtor and its subsidiaries. Yet she took no steps to discover and assert any rights she had for more than ten years. In such circumstances I can see no reason for extending any indulgence to the plaintiff beyond the period of the New York statute of limitations. In my opinion it would be a mischievous practice to disregard state statutes of limitation whenever federal courts think that the result of adopting them may be inequitable. Such procedure would promote the choice of United States rather than of state courts in order to gain the advantage of different laws. The main foundation for the criticism of *Swift v. Tyson* was that a litigant in cases where federal jurisdiction is based only on diverse citizenship may obtain a more favorable decision by suing in the United States courts. The exercise of a wide discretion as to whether to apply the state statutes of limitation would tend to promote the assertion of moral superiority on the part of the federal courts since they would be setting up rules of limitation which they would regard as more equitable than those of the state courts in situations where neither Congress nor the Federal Rules of Civil Procedure have prescribed limitations of their own. Moreover, any such practice will give rise to a new and difficult class of cases in which the United States courts in dealing with equitable claims will have to determine whether the rule to be applied is one of substantive law or of remedial rights.

In view of the foregoing I think we should hold that the plaintiff's claim is not established on the merits and that in any event it is barred by the New York ten year statute of limitations. Accordingly the judgment of the court below should, in my opinion, be affirmed.

[fol. 123] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of June, one thousand nine hundred and forty-four.

Present: Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Jerome N. Frank, Circuit Judges.

GRACE W. YORK, Plaintiff-Appellant,

v.

GUARANTY TRUST COMPANY OF NEW YORK, Defendant-Appellee

Appeal from the District Court of the United States for the Southern District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and remanded for further proceedings in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 124] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Grace W. York v. Guaranty Trust Company of New York. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed June 29, 1944. Alexander M. Bell, Clerk.

[fol. 125] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 126] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 9, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, limited to the first question presented by the petition for the writ.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Roberts and Mr. Justice Douglas took no part in the consideration or decision of this application.